

STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Commonwealth Edison)	
)	Docket No. 07-0566
Proposed general increase in electric rates and)	
revision of other terms and conditions of service.)	

SUMMARY OF POSITIONS
OF THE PEOPLE OF THE STATE OF ILLINOIS

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NOW COME the People of the State of Illinois (“People”), by Lisa Madigan, Attorney General of the State of Illinois (“AG”), and pursuant to Illinois Commerce Commission’s (“Commission” or “ICC”) rules, 83 Ill. Admin. Code Part 200.800, hereby file this Summary of Positions in accordance with the schedule in the above captioned proceeding. The summaries contained herein do not include each and every fact, point, argument or opinion contained in the testimony of the People’s witnesses, or the Initial and Reply Briefs of the People. These summaries are intended to present the key elements of the People’s positions and are not a substitute for the People’s testimony or the People’s Initial or Reply Briefs. Any facts, points, arguments or opinions that are not mentioned in this summary are not waived, withdrawn, changed or abandoned.

II. OVERALL REVENUE REQUIREMENT AND REVENUE DEFICIENCY

In their Initial Brief, the People argue that Commonwealth Edison (“ComEd” or “Company”) has overstated its revenue deficiency. (AG IB, p. 2). The People argue that ComEd’s calculated revenue requirement of \$601,350,000, which under current rates results in a revenue deficiency of \$355,402,000, “grossly exaggerates ComEd’s revenue deficiency.” *Id.* The People calculate a revenue deficiency of \$43,993,000, far less than what ComEd wants the Commission to approve.

IV. RATE BASE

A. Overview

The People propose a series of adjustments to ComEd’s test year rate base, including adjustments to net plant in service, accumulated depreciation, accumulated deferred income taxes, and customer advances for construction. AG/CUB Ex. 5.1. Based upon the testimony of AG/CUB (“Citizen’s Utility Board”) witness David Effron, record evidence and commission practice, the People propose to ultimately reduce the Company’s test year rate base by \$869,954,000 to a total of \$6,146,695,000. *Id.*

B. Uncontested Issues (Including the Contested Stipulation)

1. Plant

e. Contested Staff-Proposed Adjustments Related to the Stipulation: The Stipulation Should Be Rejected Because the ICC Lacks Authority to Approve It, and It Results in Rates That Are Not Just And Reasonable.

ICC Staff entered into a Stipulation with ComEd that includes, *inter alia*, the recalculation of the Company's rate base to eliminate all of ComEd's known and measurable growth in accumulated depreciation in 2007 associated with capital additions for that year, an adjustment worth at least \$323,533,000 according to Staff's own calculations. (See ICC Staff Schedule 2.2); "Stipulation Concerning Incorporation of Certain Adjustments From the Original Cost Audit and Resolution of Certain Revenue Requirement and Other Issues," ("Stipulation") Staff-ComEd Joint Ex. 1, filed April 10, 2008. The Stipulation resolves certain revenue requirement issues as well as adjustments related to the Original Cost Audit ("OCA") that is the subject of a separate Commission proceeding. The AG takes issue with the fact that although the audit was not presented as evidence in this case, ComEd and the ICC Staff nevertheless relied upon their respective evaluations of the OCA Report (as well as the evidence submitted by other parties and the responses to discovery in this docket) in arriving at their decision to enter into the Stipulation. (AG IB, pp. 3-4). The AG argues that the Stipulation must be rejected because the Commission has no authority to approve it and, further, it would lead to unjust and unreasonable rates for ratepayers. *Id.* at 4-5.

i. The Commission Lacks the Authority to Approve the Proposed Stipulation Between ComEd and ICC Staff.

The AG argues that the Commission cannot adopt the Stipulation's proposed resolution of issues because to do so would be unlawful, under principles established in Business and Professional People for the Public Interest v. Illinois Commerce Commission, 136 Ill.2d 192 (1989) ("BPI I"). (AG IB, p. 4). In its analysis of the relevant legal standard, the AG states that in *BPI I*, the Illinois Supreme Court established rules for Commission review of "settlements" proposed by fewer than all parties to a Commission investigation or docket. *BPI I*, 136 Ill.2d at 216-218; AG IB p. 4. The AG cites to the *BPI I* standard that a partial settlement can be adopted only when it is supported by substantial record evidence to ensure that the Commission does not make unsupported decisions on matters within its authority. *Id.*

Applying the *BPI I* standard to the facts of this case, the AG argues that the Stipulation's terms are not supported by substantial evidence because (i) they are premised on an analysis of an audit that is not in the record, (ii) other parties have not reviewed the audit as part of this proceeding, and (iii) the Commission has specifically stated that the audit will be reviewed in a separate formal proceeding that it has only just commenced. *Id.* The AG's Initial Brief points out that no discovery and no testimony have been prepared in connection with the audit in this case or in the new ICC proceeding, and further argues that the Commission cannot lawfully rule on the merits of the Stipulation, and in fact, must reject its proposals in their entirety. *Id.* Additionally, the AG states that even if the Commission were able to consider the Stipulation at all, which it is not, it would still have to reject its terms because the Commission cannot make a decision on issues in this case based on evidence not in the record, but that is part of another docket, citing to 220 ILCS 5/10-103. *Id.* The AG concludes that the Commission is obliged to reject the Stipulation in its entirety due to the absence of the information underlying the

Stipulation from the record, and the absence of any evidence supporting the specific proposals contained in that agreement from the record.. *Id.*

ii. If Adopted by the Commission, the Proposed Stipulation Would Result in Rates That Are Not Just and Reasonable.

The AG takes issue with the fact that as part of the Stipulation, Staff has agreed to withdraw its proposed adjustment to plant in service and accumulated depreciation for the entire 2007 calendar year. *Id.* at 5; Staff-ComEd Joint Ex. 1, Stipulation at 4. The AG argues that if the Commission were to adopt this provision, that would not only violate the spirit and the letter of the Commission's rule on *pro forma* adjustments, but it would also impact the Company's revenue requirement -- and rates paid by the company's customers -- by increasing ComEd's rate base by hundreds of millions of dollars. (AG IB, p. 5). The AG believes that the resulting rate base would be not so much a "mismatch" of revenues and expenses as pure accounting chaos, which would result if the Commission were to include *pro forma* adjustments reflecting capital additions through June 30, 2008, but then allow accumulated depreciation adjustments only through December 31, 2006. *Id.* During the hearings, AG/CUB witness Effron, an expert with more than 30 years experience in utility accounting, also remarked that he was not aware of any other utility commission in the country that would allow a company to over-state rate base by recording plant in service as of one date but recording an accumulated depreciation offset as of 18 months earlier. Tr. at p. 599-600.

C. Contested Issues

1. Plant

a. Pro Forma Capital Additions

i. Propriety of Additions

Regarding ComEd's projection of additions to plant in service for March through September of 2008, the AG argues that they should be based on its actual historic experience and states that *pro forma* adjustments to historical test years are made where the changes are "reasonably certain to occur" in determinable amounts within twelve months of the tariff filings. (AG IB, p. 5-6); 83 Ill. Admin. Code 287.40.

ComEd projects additions of \$598.0 million, or \$85.4 million per month, over the seven months from March 1, 2008 through September 30, 2008. ComEd Ex. 21.0, p. 2. This same exhibit shows the actual additions to jurisdictional plant in service in 2007 were \$767.8 million, which translates into approximately \$64.0 million of additions per month. *Id.* The actual plant additions in the first two months of 2008 were \$114.1 million, approximately \$57.0 million per month. *Id.* Thus, the actual average of plant additions has been well below \$85.4 million per month. *Id.* The AG argues that ComEd's projections cannot be considered "reasonably certain" to occur and that, despite putting forth what the company calls a "an unprecedented quantity of data" regarding the proposed capital additions for the first three quarters of 2008 (ComEd Ex. 36.0), the Company was not able to show at any time how it would finance those proposed additions. AG IB, pp. 5-6; Tr. at p. 1067; AG Cross Ex. 9.0.

AG/CUB witness Effron has proposed modifying ComEd's projection of additions to plant in service based on its actual experience through December 31, 2007. AG IB, pp. 5-6. ComEd

asserts that the approach advocated by Effron is “overly simplistic.” ComEd Ex. 25.0, p. 17. The AG states that while Mr. Effron’s approach may appear simple, the result is a more accurate reflection of the Company’s actual historical experience. *Id.* Mr. Effron’s proposal modifies the Company’s forecast so that it is consistent with the Company’s actual experience, resulting in a decrease of \$49,108,000 to the forecast of net additions to distribution plant in service, and a decrease of \$8,264,000 to the Company’s forecast of net additions to jurisdictional general and intangible plant in service. AG/CUB Ex. 5.0, p. 4.

ii. Impact On Test Year Rate Base:

(a) Accumulated Provisions for Depreciation and Amortization

The AG’s argument can be split into two sections: (i) net plant, not gross plant, is the determining factor in calculating total utility rate base and (ii) all offsetting adjustments from the revenue requirement test year and from post-test year period should be included in the calculating rates to comply with the “matching” and “representative” requirements of the test-year principle.

Net plant, not gross plant, is the determining factor in calculating total utility rate base. The AG states that the Commission’s rules on *pro forma* adjustments to historical test years and on the calculation of rate base require that net plant, **not** gross plant, is the determining factor in calculating total utility rate base. AG IB, p. 7. The AG cites the Commission rule on the submission of *pro forma* adjustments, which states as follows:

Section 287.40 *Pro Forma* Adjustments to Historical Test Year

A utility may propose *pro forma* adjustments (estimated or calculated adjustments made in the same context and format in which the affected information was provided) to the selected historical test year for ***all*** known and measurable changes in the operating results of the test year. These adjustments ***shall reflect changes affecting the ratepayers in plant investment***, operating revenues, expenses, and cost of capital where such changes occurred during the selected historical test year or are reasonably certain to occur subsequent to the historical test year within 12 months after the filing date of the tariffs and where the amounts of the changes are determinable. Attrition or inflation factors shall not be substituted for a specific study of individual capital, revenue and expense components. Any proposed known and measurable adjustment to the test year shall be individually identified and supported in the direct testimony of the utility. Each adjustment shall be submitted according to the standard information requirement schedules prescribed in 83 Ill. Admin. Code 285.

83 Ill. Admin. Code 287.40 (emphasis added).

The AG then argues that the fact that *pro forma* adjustments may be made only for *all* “known and measurable changes” in test year operating results, and not only for selected changes, clarifies the rule’s use of the term “plant investment” as net plant. AG IB, p. 7. Furthermore, the admonition in the language of the rule, providing that these adjustments “shall

reflect changes affecting ratepayers in plant investment”, points to the ratemaking process -- and its necessary reliance on net plant, not gross plant, to calculate rates -- as the proper interpretive tool. *Id.*; *Verizon Communications, Inc. v. F.C.C.*, 535 U.S. 467, 486, 526, 122 S.Ct. 1646, 1680 (2002) (stating that rates under traditional public utility model are calculated on rate base subject to deductions for accrued depreciation).

In interpreting the rule further, the AG states that the rule not only specifies the precise manner in which any *pro forma* adjustments to jurisdictional rate base must be recorded, but it significantly requires that *pro forma* adjustments be prepared in the same manner as is required under the Commission’s standard information requirements filings. *Id.* at 8. The AG’s Initial Brief cites to 83 Ill. Admin. Code 285.2005, “Schedule B-1, Jurisdictional Rate Base Summary by ICC Account”, which specifies that a utility’s schedule of rate base components is to include:

- 1) Gross utility plant in service at original cost;
- 2) Reserve for accumulated depreciation;
- 3) Net utility plant in service;
- 4) Other individual items comprising rate base separately listed, such as working capital, construction work in progress included in rate base, customer advances and accumulated deferred income taxes; and
- 5) Total rate base.

Based on these rules, the AG argues that the Commission’s rules repeatedly echo the theme that the ratemaking process requires rate base information that reflects net plant investment. *Id.* The AG also cites to the Illinois Industrial Energy Consumers (“IIEC”) witness Gorman, who testified that although Section 287.40 does not specifically refer to gross plant or net plant, “since rate base is changed by net plant not gross plant investments, it seems reasonable to conclude that what the rule is referring to is changes in net plant” and an informed analyst would understand the rule in that way.” Tr. at 857. Mr. Gorman also testified that *everything* that impacts rate base in the post test year period must be considered, not only items that increase rate base, but also items that decrease rate base, including recovery of plant investment from ratepayers. Tr. at 849.

Impact of *pro forma* capital additions on test year rate base: all offsetting adjustments from the revenue requirement test year and from post-test year period should be included in the calculating rates to comply with the “matching” and “representative” requirements of the test-year principle. AG/CUB witness Effron made adjustments for accumulated depreciation to comply with the test-year rule “matching” and “representative” principles, which are required by test-year principles to prevent the mismatching of revenues and expenses that are part of the revenue requirement formula. AG IB, p.9; *Business and Professional People for the Public Interest vs. Illinois Commerce Commission*, 146 Ill.2d 175, 238 and 242 (1991) (“BPI II”). The AG claims that by adjusting for the actual accumulated depreciation reserve associated with capital additions made in the test year, Mr. Effron’s adjustments match elements that raise the revenue requirement with elements that reduce the revenue requirement in the same time period. AG IB, p. 9. Furthermore, by making similar adjustments to the company’s *pro forma* additions to utility plant, Mr. Effron’s depreciation adjustments reflect the net change to ComEd’s cost of service that is expected will be the result of post test year plant additions, thereby resulting in rates more representative of costs that will exist when the new rates go into effect. *Id.*

The AG's Initial Brief cited to various ICC proceedings where the Commission specifically affirmed these policies and Mr. Effron's approach. The Commission adopted *pro forma* adjustments to the reserve for accumulated depreciation precisely because those adjustments matched the period of *pro forma* plant additions. *Illinois Power Company, Proposed general increase in electric rates*, ICC Docket No. 01-0432, Order, March 28, 2002, at 20-21. The Commission also recognized the need to reflect the utility's costs at the time new rates are implemented. *Union Electric Company, Proposed general increase in natural gas rates*, ICC Docket No. 03-0009, Order, October 22, 2003, at 9-10. The ICC ordered that the company be permitted to record *pro forma* capital additions in rate base "only to the extent that they exceed increased accumulated depreciation," accounting the Commission reasoned "...more accurately matches the costs and revenues that may be expected for the period during which the rates are in place." *Id.*

Arguing that the ICC's rules on test year, post-test year known and measurable changes and on *pro forma* adjustments must be applied in a manner that is consistent with the ratemaking process, the AG asserts that in the instant case, the ICC must take into account all changes to rate base expected to affect ratepayers in the test year so as to avoid mismatching of revenues and expenses. AG IB, p. 10. To do this, the AG proposes that the Commission adopt AG/CUB witness Effron's accounting adjustments for accumulated depreciation, including those associated with the Company's *pro forma* capital additions.

2. Accumulated Provisions for Depreciation and Amortization

AG/CUB witness Effron proposed adjustments to ComEd's rate base include a provision for accumulated depreciation to account for that portion of utility plant investment that has been recovered from ratepayers. Tr. at 859-860. According to Effron's calculations, the accuracy of which has not been challenged by the Company, that return of investment to ComEd amounts to \$566,150,000. AG/CUB Ex. 5.1, Sched. B.

Accumulated depreciation is one of the adjustments to gross plant needed to arrive at an accurate calculation of net plant, according to the AG. AG IB, p. 10. The net plant component of rate base has been described as investment in plant minus accumulated depreciation. *See Association of Oil Pipe Lines vs. F.E.R.C.*, 83 F.3d 1424, fn 16 (1996). The AG correctly points out that Effron's approach -- accounting for all offsets to plant in service to calculate net plant in service -- is the proper way in which to calculate rate base is not a matter of controversy. *Id.* In considering rate base adjustments associated with post-test year capital additions, the AG points out that the Commission uses net plant to calculate impacts on test year rate base and that the ICC standard information filing requirements make this type of adjustment mandatory for utilities seeking rate increases. *Id.* at 11; 83 Ill. Admin. Code 285.200. Consistent with these principles, Mr. Effron's calculations were based first on changes in the Company's plant in service from December 31, 2006 to December 31, 2007 (including both additions to and retirements from that plant), and second, upon adjustments to gross plant that accurately reflect investment contributions made by the utility *and* by ratepayers. *Id.*

Mr. Effron's changes in the reserve for accumulated depreciation reflect the Company's actual changes in the balance for that account for the test year and through December 31, 2007, plus an adjustment to reflect the *pro forma* balance of accumulated depreciation associated with the company's *pro forma* capital additions for the period January 1, 2008 through September 30,

2008. *Id.* This methodology reflects the actual growth in depreciation reserve for the test year and for growth taking place in 2008 as the post-test year plant additions in 2008 take place. *Id.*

3. Accumulated Deferred Income Taxes (ADIT)

The AG argues that, as with accumulated depreciation, it is improper and inconsistent to include post-test year plant additions in rate base without recognizing that a portion of those additions will be financed by the customer supplied, zero-cost capital represented by the growth in accumulated deferred income taxes. *Id.* Therefore, the AG argues that the test year balance of ADIT should be adjusted to reflect the growth that will be available to finance the growth in plant balances after the test year. *Id.* ComEd has not recognized the source of funds that will be provided by the growth in ADIT as the post-test year plant additions go into service and it will continue to record tax depreciation in excess of book depreciation on plant in service. *Id.* That excess depreciation will reduce income taxes currently payable, thereby providing cash that is available to finance its post-test year additions to plant. *Id.* at 12.

AG/CUB witness Effron has calculated the growth in the balances of plant-related ADIT based upon the actual balances through September 30, 2007, the most recent data available from the company. *Id.* These calculations show growth of \$100,845,000 in the balance of plant related ADIT from December 31, 2006 to September 30, 2008, which is \$88,297,000 greater than ComEd's adjustment to the balance of ADIT. AG/CUB Ex. 5.1, Sched. B-2. Therefore, the AG recommends that the *pro forma* balance of ADIT deducted from plant in service in the computation of rate base be increased by that same amount. AG IB, p. 11. Reducing ComEd's adjustment for post-test year plant additions by related growth in the balance of ADIT does nothing more than allowing investors to earn a return on their actual investment in utility operations – but only on that actual investment. *Id.* Unless the ICC intends to authorize ComEd to earn a return not on post-test year plant additions that are financed by customers, the AG says that the post-test year growth in the balance of ADIT that is used to finance the post-test year plant additions must be recognized. *Id.*

d. Customer Advances for Construction

Customer advances for construction are funds received from customers to defray the cost of construction and represent customer-supplied funds available to the utility. When the related construction is completed, these funds are either refunded to the customer or retained by the utility and credited to the cost of the plant. ComEd deducts \$5,076,000 of customer advances as of a single point in time – December 31, 2006. ComEd Schedule B-15. As of December 31, 2007, the balance of these line extension deposits was \$22,083,000. The AG argues that this balance should be deducted from rate base so it more closely matches the balance that will likely be outstanding during the new rate period. AG IB, p. 13.

In addition, ComEd receives customer advances for distribution projects that it does not deduct from rate base on the ground that they represent advances for work not yet performed. The issue here, however, is that regardless of the funds obligation, these customer advances represent cash received by the company. Tr. at 1016:12-17. Even as the work is performed, it is likely that the company will get new advances according to AG/CUB witness Effron. See AG/CUB Ex. 5.3. ComEd has not presented any evidence that the balance of advances as of December 31, 2006 was abnormal or unrepresentative. AG IB, p. 13. The twelve-month average (which avoids

seasonal distortions) of the balance of distribution related customer advances -- \$7,904,000 -- should be included in the total customer advance deduction from rate base according to the AG. *Id.* Including both line extension and distribution project adjustments, the total deduction from rate base for customer advances should be \$29,987,000. *Id.*; AG/CUB Ex. 5.1, Sched. B-3.

V. OPERATING EXPENSES

C. Contested Issues

1. Incentive Compensation

AG/CUB witness Effron proposes three adjustments to ComEd's request to recover \$18,343,000 of incentive compensation: (i) the elimination of the *pro forma* adjustment to increase incentive compensation for 2007 targets, (ii) the elimination of incentive compensation related to financial goals, and (iii) the elimination of all stock-based compensation. These eliminations result in a total adjustment to incentive compensation expense included in the Company's revenue requirement of \$17,868,000. AG IB, p. 14; AG/CUB Ex. 5.1, Sched. C-2. ComEd is seeking recovery of \$18,343,000 in incentive compensation: \$14,958,000 in actual expenses incurred in the 2006 test year and a *pro forma* adjustment of \$3,385,000 to reflect 2007 incentive compensation expenses. This does not include stock based compensation, which ComEd does not include in its definition of incentive compensation. AG/CUB Ex. 2.0, p. 17.

As noted by Staff witness Hathhorn, the main consideration affecting rate recovery of incentive compensation has been whether the goals and costs "confer upon ratepayers specific dollar savings or other tangible benefits." ICC Staff Ex. 14.0, p. 13. The AG and Staff agree that if the Commission allowed ComEd's proposed *pro forma* adjustments that increase incentive compensation to reflect 2007 targets, ratepayers would pay for benefits that they did not get in the test year. AG IB, p. 14; ICC Staff Ex. 1.0, p. 9. For example, the AG states that if a particular goal is related to controlling costs, the actual costs incurred in 2006 would not reflect the achievement of targets in 2007, even assuming that target is achieved in 2007. *Id.* Ratepayers should not pay incentive compensation based on achieving targets in 2007 when the actual costs incurred in 2006 do not reflect the achievement of those targets. Therefore, the AG argues that the *pro forma* adjustment related to the achievement of 2007 targets should be eliminated, reducing *pro forma* test year operation and maintenance expense by \$3,385,000. AG IB, p. 14; AG/CUB Ex. 1.1, Sched. C-2.

The AG also points out that ComEd's Long Term Incentive Plan ("LTIP") is still based upon the same financial goal – an earnings-per-share ("EPS") goal – which the Commission rejected in Docket No. 05-0597. Final Order, Docket No. 05-0597, p. 96. The AG agrees with Staff witness Hathhorn, who states that the "mere fact that the goals relate to ComEd, as opposed to Exelon, is irrelevant" since the ComEd specific goals in and of themselves do not "confer upon ratepayers specific dollar savings or other tangible benefits." AG IB, p. 15; ICC Staff Ex. 14.0, p. 13 (quoting from ICC orders in dockets number 05-0597, p. 96, 04-0779, p. 44, 03-0403, p. 15). The AG states that even after ComEd's programs were revised in 2007 to address the Commission's concerns as stated in Docket No. 05-0597, these revisions were not in place in 2006, and would not be reflected in 2006 test year costs. AG IB, p. 15. Therefore, the determination of the 2006 incentive compensation that is includable in the Company's revenue requirement must be based on the incentive compensation as it existed in 2006. *Id.* Following the same practice used in

Docket No. 05-0597, accordingly, 50% of the actual 2006 test year compensation should be eliminated from *pro forma* test year operation and maintenance expense, thus reducing *pro forma* expenses by \$7,479,000. *Id.*

Following this same reasoning, stock based compensation in the form of performance shares and stock options should be eliminated according to the AG. *Id.* The AG states that the form of this compensation by itself creates an incentive to maximize the Exelon stock price without regard to whether the maximization of the price of the stock is in the best interest of ratepayers. *Id.* If company management is successful in increasing the price of Exelon stock, company shareholders should be gladly willing to absorb the cost associated with this incentive compensation. *Id.* Elimination of stock based compensation further reduces *pro forma* test year operation and maintenance expense by \$7,004,000. AG/CUB Ex. 5.1, Sched. C-2. The total adjustments proposed by the AG equal \$17,868,000 which should be deducted from the *pro forma* test year jurisdictional operating expenses. *Id.*

3. Merger Expenses

The AG argues that the Commission should eliminate all expenses associated with the proposed merger of Exelon Corporation and Public Service Enterprise Group, not just the “incremental” expense adjustment proposed by ComEd which reduced test year operation and maintenance expenses by \$5,281,000. AG IB, p. 16; ComEd Ex. 7.0 (corrected), p. 39. ComEd’s adjustment does not eliminate the salary and benefits of employees who spent time on merger related activities in 2006. *Id.* To the extent that these employees’ time was devoted to merger related activities, the AG states that it was not incurred in the provision of utility service in the test year, and therefore should not be included in the company’s revenue requirement. *Id.*

ComEd’s reason for not removing the merger related salaries and benefits expenses is that the time of those employees subsequent to the test year will be spent performing utility related duties. AG/CUB Ex. 2.0, p. 16 (response to Staff Data Request DLH-2.01). However, the AG argues that it is unclear how much time these employees will be spent performing utility related duties. AG IB, p. 16. ComEd asserts that certain employees performed merger related work in addition to their usual duties and that by eliminating the wages and benefits of those employees, the ICC will understate the Company’s cost of service. *Id.* If this is true, then the AG states that it means that ComEd employees performed any merger work for free – which in turn means that no costs should have been assigned to that work. *Id.* Even assuming then that it is known how much time employees will spend subsequent to the test year on utility-related duties, it is also possible that it would reduce the time – and the cost – of other employees performing such duties. *Id.*

What is known is that ComEd did assign costs to the merger related work performed by the employees. *Id.* As those costs do not relate to the provision of delivery services, they should not be included in the delivery services revenue requirement. *Id.* The effect of eliminating merger-related salaries and benefits is to reduce *pro forma* test year operation and maintenance expense by \$2,546,000. AG/CUB Ex. 5.1, Sched. C-2.

4. Administrative and General Expenses

a. Exelon Way Severance Amortization

The AG argues that the Commission should reject ComEd's claim that the ICC authorized the establishment of a regulatory asset consisting of Exelon Way severance costs. AG IB, p. 16. While the company properly includes its actual 2006 severance costs of \$294,000, the proposed \$18,791,000 *pro forma* adjustment reflects Exelon Way severance costs that were incurred in the years 2003 and 2004. ComEd Schedule 11.3. ComEd claims that in Docket No. 05-0597 the Commission authorized establishment of a regulatory asset of \$158 million to be amortized over 7.5 years, with 89.2% of the annual amortization to be included in jurisdictional expenses. ComEd Ex. 25.0, p. 57 (citing the Final Order, ICC Docket No. 05-0597 at 90). Staff generally accepts the Company's position. ICC Staff Ex. 14.0, pp. 17-18.

The AG correctly points out that the ICC Order on which they rely does not create a 7.5 year amortization period – in fact, does not even use the terms “regulatory asset” or “amortization” – in its discussion of Exelon Way severance costs at page 90. ICC Final Order, 05-0597, p. 89-90; AG IB, p. 17. Although the Commission did allow inclusion of approximately \$18.8 million of Exelon Way severance costs in jurisdictional operation expenses in Docket No. 05-0597, the expense reflected the actual costs incurred in the 2004 test year. ICC Final Order, 05-0597, p. 89-90; AG IB, p. 17. There was testimony in that case that the actual costs incurred in 2005, \$21 million on a total company basis, “results in an implied amortization period of over seven years (\$158 million divided by \$21 million = 7.5 years).” Final Order, Docket No. 05-0597, p. (citing ComEd Ex. 19.0 Corr., 46:1008-17). There is no mention of a formal request by ComEd to defer costs related to the Exelon Way program incurred in 2003 and 2004 or to amortize those costs prospectively for ratemaking purposes: “[T]he record establishes ComEd properly seeks recovery of its initial severance costs for a program expected to produce hundreds of millions of dollars in savings over the life of these rates.” AG IB, p. 17.

A regulatory asset can be recorded if it is “probable” that future revenues at least equal to the capitalized cost will result from inclusion of that cost in prospective revenue requirements. *Id.* According to the AG, nothing in the analysis and conclusion on this issue in Docket No. 05-0597 can reasonably be interpreted to have created such a probability of such recovery. *Id.* Therefore, the proposed *pro forma* adjustment related to Exelon Way severance costs should be eliminated and *pro forma* test year operation and maintenance expenses reduced by \$18,791,000. AG/CUB Ex. 5.1, Sched. C-2.

b. Accounts 930-923

The AG states that administrative and general (“A&G”) expenses include costs charged to FERC Accounts 920 – 935. Accounts 920 – 923 include salaries, wages, and related expenses of officers and employees that are not directly associated with the transmission, distribution, or customer service operations of the system (Accounts 920 – 922) and outside services expense (Account 923). Taken together, these accounts reflect those A&G expenses which are related to ComEd's actual administrative operations and exclude those A&G expenses more properly evaluated individually.

The AG argues that ComEd's proposed test year expense level – significantly higher than any historical record – should be rejected. AG IB, p. 18. Before any adjustments, ComEd charged a total of \$201,589,000 to Accounts 920-923 in 2006. ComEd Schedule C-4, p. 5. In 2004, expenses charged to those same accounts were \$180,248,000. AG/CUB Ex. 2.0 at 27:589-603. In 2005, expenses charged to those same accounts were \$158,121,000. *Id.* Total expenses charged to these accounts for 2007 are not yet available; however, through the first nine months

of 2007, ComEd charged \$140,648,000. AG IB, p.18. This translates into an annualized expense level of \$187,579,000. *Id.*

According to the AG, a reasonable basis for calculating a normalized level of expenses in this case is to use the ICC's final order in Docket No. 05-0597. *Id.* In that case, the Commission allowed \$125,835,000 of expenses charged to Accounts 920 – 923, excluding Exelon Way severance costs, in the Company's jurisdictional revenue requirement. *Id.* In the present case, the Company includes *pro forma* jurisdictional expenses of \$161,727,000 in Accounts 920 – 923, again excluding Exelon Way severance costs. *Id.* at 18-19. Thus, the expenses in the present case exceed the expenses in Docket No. 05-0597 by \$35,892,000, or approximately 28.5%. *Id.* at 19. This is substantially in excess of the expense growth that can be explained by normal inflation in the two years from 2004 to 2006 according to the AG. *Id.* To the extent this increase has not been satisfactorily explained, the AG urges to Commission to adjust *pro forma* expense levels.

Taking the level of A&G expenses allowed in that instance, adjusting for inflation in the two years from the 2004 test year in that case to the 2006 test year, adjusting for the reclassification of expenses as proposed by ComEd, and including the proposed elimination of merger costs and incentive compensation (as discussed above) results in a jurisdictional revenue requirement in the present case of \$156,796,000 in expenses charged to Accounts 920 – 923. *Id.* That amount is \$12,408,000 greater than the level of expenses allowed by the Commission in Docket No. 05-0597, as adjusted. *Id.*; AG/CUB Ex. 1.1, Sched. C-2.1. Unless the Company can justify the growth in those A&G expenses from 2004 to 2006 and can establish that the expenses incurred in 2006 are representative of the expenses that will be incurred prospectively, the A&G expenses included in the Company's delivery services revenue requirement should be reduced by this amount according to the AG. AG IB, p. 19.

Both ComEd and ICC Staff reject this approach as reflecting a position “that inflation factors are more appropriate than ComEd's actual costs,” ComEd Ex. 40.0, p. 26, or “calculated in a manner rejected by the Commission in the last case,” ICC Staff Ex. 15.0, p. 18. AG/CUB witness Effron's testimony focuses on the unexplained increase in costs, which cannot be attributed to inflation alone, and which is not attributed to any other specific items. AG IB, p. 19. Mr. Effron's adjustment for inflation results in a growth of \$6,472,000. AG/CUB Ex. 2.0, p. 29. The AG states that the Commission never rejected this approach in the prior ComEd rate case (Docket No. 05-0597) and no party in that case proposed that A&G Accounts 920 through 923 be examined together, or made a comparison between charges to those accounts from one test year to another. Accounts 920 through 923 were examined, but in the context of reviewing ComEd's proposed functionalization, corporate governance and Exelon BSC expenses. Final Order, ICC Docket No. 05-0597, pages 60, 68, 72, 77. The Commission noted the same concerns raised by Mr. Effron in this proceeding as a reason to find “unpersuasive” ComEd's requested inclusion of \$260,909,000 administrative and general expenses:

However, ComEd failed to explain what the individual increases entailed. Moreover, conspicuously absent is a discussion about how ComEd's proposed increase to overall A&G expense is reasonable. The Commission cannot properly evaluate ComEd's request without being able to see the individual expenses contained in the A&G accounts and the rationale for any increases.

ICC Final Order, Docket 05-0597, pp. 67-68. The AG states that the Commission should reject similar unexplained increases in A&G expenses, and accept the AG's proposed elimination of \$12,680,000 in A&G expenses from the ComEd revenue requirement. AG IB, p. 20.

c. Rate Case Expenses: (i) 2005 Rate Case Expenses Amortization, (ii) 2005 Rate Case Expenses in the 2006 Test Year, and (iii) 2005 Rate Case Rehearing Expenses in the 2006 Test Year

ComEd proposes recovery in the present case of three categories of expenses associated with its last rate case, ICC Docket No. 05-0597: the continuing amortization of the rate case expenses approved in that docket; the recovery of amortized costs associated with the rehearing of that docket; and the recovery of \$2,986,000 in additional rate cases expenses from that docket. The Commission should reject recovery of these expenses.

The purpose of including normalized rate case expenses in a utility's recoverable operating expenses is to allow a reasonable opportunity to recover the cost of the rate case by including what is deemed to be a "normal" rate case expense in the cost of service. AG IB, p. 21. The problem that the AG has with ComEd's proposal is that the company proposes to recover two sets of rate case expenses: costs from the 2005 case, and costs associated with the current rate case. *Id.* The AG states that if a rate case expense in a given case is normalized over three years, but the subsequent rate case does not take place for another five years, that rate case expense from the first case will be over-recovered. *Id.* In such circumstances, there is no practice the AG is aware of where the utility offers – or a regulatory commission requires – the utility to refund to ratepayers the over-recovered rate case expense. *Id.* In this case, ComEd has initiated a new rate case proceeding just two years after the prior one. The AG advocates that it is appropriate that the treatment of any "under-recovered" rate case expense should be symmetrical to the treatment of over-recovered rate case expense and urges the Commission to reject recovery of prior rate case expenses once a new rate case is initiated. *Id.*

The AG also advocates for the elimination of the amortization of the rehearing costs and the excess rate case costs related to Docket No. 05-0597. *Id.* Allowing recovery of those costs prospectively from ratepayers is an exercise in retroactive ratemaking. *Id.* ComEd makes baseless and conclusory assertions that the Commission would have found those expenses substantiated, but there is no way to know if that would be true; ComEd is seeking to relitigate an issue from the 05-0597 proceeding and demonstrate that its costs in that case were not fully recovered because the company can now provide better documentation of its expenses. *Id.* The ICC is urged to eliminate these expenses from ComEd's operating expenses, resulting in a \$4,212,000 reduction to the company's *pro forma* operation and maintenance expense. *Id.*

5. New Business Revenue Credit

Based upon the AG's proposed adjustments to plant in service described above, it is also necessary to adjust the new business revenue credit. On ComEd Workpaper WPC-2.16, the revenue credit related to new business plant additions is based on general customer growth rates but does not incorporate the addition of new customers related to specific plant additions. AG IB, p. 22. Since the AG proposes that the level of plant additions is based on the actual levels of plant additions in 2007, the calculation of the revenue credit related to new business plant additions must be modified so that it is consistent with actual plant additions in 2007. *Id.* ComEd has recalculated

the new business revenue credit based on actual customer growth in 2007, and projected customer growth over the first nine months of 2008 is \$31,177,000. AG/CUB Ex. 5.2. This is \$4,776,000 greater than the new business revenue credit reflected by ComEd in its calculation of *pro forma* operating income under present rates. AG IB, p. 21. Therefore, the new business revenue credit should be increased by \$4,776,000. *Id.*

ComEd states that AG/CUB witness Effron overstates the potential growth when he relies upon 2007 data – a year the company argues is not typical. ComEd Ex. 40.0, p. 31-32. Regardless of whether the growth in 2007 is or is not typical, it represents what actually happened and is therefore consistent with the inclusion of actual 2007 plant additions in rate base. *Id.* ComEd agrees that in both the current rate case, and the previous case, Docket No. 05-0597, the proposed rates sought by the company were used to estimate the total amount of new business revenue the company could expect. Tr. at 1019: 21-22. This mirrors what Mr. Effron proposes to do in the current case: adjust the company's total revenue requirement for the anticipated increase in revenue, generated by new customers using the company's own proposed rates, just as the company did in its last rate case. *Id.*

The adjustment to reflect customer growth is an adjustment to operating revenues on ComEd Schedule C-2, not an adjustment to "Other Revenues"; thus, the method of incorporating the new business revenue credit should be modified. *Id.* at 21-22. To accurately reflect the impact of this adjustment, it should be shown as an increase to operating revenues – which in turn results in an increase to the total revenue requirement but not the calculated revenue deficiency. *Id.* at 22.

VII. NEW RIDERS

A. Overview

ComEd presented two new rider proposals, Rider SMP (System Modernization Projects) and Rider SEA (Storm Expense Adjustment). ComEd Ex. 1.0, p. 10. The AG strongly asserts and argues that the proposed Rider SMP and Rider SEA violate several critical ratemaking precepts, among them the prohibition against retroactive and single-issue ratemaking, as well as the requirement that rates be set in accordance with the Commission's test year rules. *Id.* at 23. Likewise, neither Rider SMP nor Rider SEA fits the criteria for the exceptions to base rate recovery of expenses permitted under law, according to the AG. *Id.* In particular, the AG strongly asserts that Rider SMP would radically alter the way utility plant investment is incorporated into customer rates, contrary to the dictates of the Public Utilities Act ("PUA") and traditional regulatory principles that require a utility to prove new plant additions are used and useful, as well as prudently incurred, before the costs of that plant addition are reflected in rates. *Id.* at 23; 220 ILCS 5/9-211. Additionally, the AG claims that these proposals would trigger piecemeal rate adjustments for isolated elements of utility revenue requirements in the absence of compelling evidence that such piecemeal rate adjustments are warranted. AG IB, p. 23. The AG urges the Commission to reject both Rider SMP and Rider SEA. *Id.* The general arguments offered against Riders SMP and SEA are that:

- Traditional regulation and Illinois case law provide a clear framework for the Commission's analysis of the companies' rider proposals.
- Riders undermine long-established principles of ratemaking.

- Illinois courts have clearly enunciated the applicable criteria appropriate for Commission approval of riders as an extraordinary cost recovery mechanism.
- The Companies' rider proposals violate the public utilities act's prohibition against single-issue ratemaking.
- The Company's rider proposals violate the requirement in the public utilities act that rates be least-cost.
- The Company's rider proposals violate the public utilities act's prohibition against retroactive ratemaking.
- ComEd's rider proposals violate the commission's test year rules.

1. Traditional Regulation And Illinois Case Law Provide A Clear Framework For The Commission's Analysis Of The Companies' Rider Proposals.

In arguing against Riders SMP and SEA, the AG directs our attention to both the PUA and Illinois court rulings regarding the utility ratemaking process, which should provide the essential regulatory and legal framework for the Commission's analysis of ComEd's rider proposals. *Id.* When the Commission enters upon a hearing for review of a utility's proposed rate increase pursuant to Section 9-201 of the PUA, it must determine whether the proposed rates are just and reasonable and do so within the regulatory parameters which prohibit retroactive and single-issue ratemaking. *Id.* at 22; *BPI II*, 146 Ill.2d at 195. For utility ratemaking purposes, riders are closely scrutinized because of the danger of single-issue ratemaking. *City of Chicago v. Illinois Commerce Comm'n*, 281 Ill.App.3d 617, 666 N.E.2d 1212 (1st Dist. 1996).

The AG states that the normal and widely recognized process used to evaluate and measure the cost of service and resulting revenue requirement for a public utility is the rate case, in which a balanced review of jurisdictional expenses, rate base investment, the cost of capital and revenues at present rates can be undertaken at a common point in time referred to as a test year. AG IB, p. 24; AG/CUB Ex. 1.0 at 6; see also *BPI II*, 146 Ill.2d at 238. The sum of those amounts -- operating costs and return on rate base -- is known as the company's revenue requirement and it represents the total revenue amount the company is permitted to recover from its customers through the rates it charges. AG IB, p. 24.

In setting rates, the AG provides that the Commission must determine that the rates accurately reflect the cost of service delivery and must allow the utility to recover costs prudently and reasonably incurred. *Id.*; 220 ILCS 5/1-102(a)(iv). AG/CUB witness Michael Brosch thoroughly explained that it is essential that there be a synchronized review of both revenue levels and cost levels within a carefully structured test period, because both revenues and costs tend to change over time as customers are added and lost, inflation and productivity changes impact costs, capital market conditions change and sales volumes fluctuate. AG/CUB Ex. MLB-1.0 at 7. All elements of a utility's revenue requirement are dynamic through time and changes that are favorable tend to offset other changes that are unfavorable. *Id.* at 11. Mr. Brosch gives an example of adding customers and the related revenue growth that can help "pay for" increases in operating expenses, while growth in the depreciation reserve or the refinancing of high-cost debt can help to offset costs of new construction activity that adds new plant in service. *Id.* The Commission's test year rules implicitly reflect this dynamic. AG IB, p. 25.

2. Riders Undermine Long-Established Principles of Ratemaking.

The AG argues against approval of Rider SMP and Rider SEA based on long-established principles of ratemaking. One such principle, the “matching principle”, inherent in test year ratemaking, recognizes the importance of matching all revenues and costs (expenses, rate base, rate of return) at a consistent period of time within a balanced period of time within a balanced test period to determine needed changes in utility service pricing. AG/CUB Ex. 1.0 at 11. Riders are able to seriously distort the matching principle under traditional ratemaking because a single expense item is tracked in isolation, thereby ignoring other changes occurring to expenses and revenues that affect a utility’s revenue requirement. AG IB, p. 25. Traditional test year ratemaking, on the other hand, creates a synchronized review of both revenue levels and cost levels within a carefully structured test period. *Id.* As long as revenues and costs remain in approximate balance, causing the utility’s earnings to stay within acceptable proximity to authorized return levels, an electric or gas utility may be able to go many years between rate cases. AG/CUB Ex. 1.0 at 7.

The AG points out that an important element of traditional test year regulation is the incentive for management to control and reduce costs, so as to maximize the opportunity to actually earn at or above the authorized return level between rate case test periods. AG IB, pp. 25-26. It is the AG’s theory that since rates are typically fixed for a period of years, the “regulatory lag” that occurs provides utility management with efficiency incentives and symmetrical risks and opportunities for both ratepayers and shareholders -- depending on cost and revenue trends -- between rate cases. *Id.* at 26; AG/CUB Ex. 1.0 at 7, 13. Another benefit of traditional test year ratemaking that the AG cites is “the intensive focus upon utility operations and costs” that occurs in a rate case in which Commission Staff and other interested parties can carefully examine or audit the components making up the revenue requirement. *Id.* at 6.

AG/CUB witness Brosch identifies several problems inherent in rider recovery of certain rate elements:

- Reduction of management incentives (by eliminating regulatory lag);
- Shifting of cost responsibility and risk to customers who are least able to influence cost levels or sales levels;
- Increases in tariff and bill complexity;
- Administrative complexity and additional costs associated with audit verification and administration of complex accounting entries, cost allocations and/or tariff calculations, often on an accelerated procedural schedule; and
- Potential for inadequate regulatory oversight and auditing of rider tariffs.

Id. at 11.

Given the importance of the matching principle in traditional ratemaking and the potential problems inherent in rider recovery of rate elements, the AG recommends that exceptions to normal test year ratemaking should only be allowed when extraordinary circumstances exist that preclude the setting of just and reasonable rates through traditional test year procedures. AG IB, p. 26.

3. Illinois Courts Have Clearly Enunciated The Applicable Criteria Appropriate For Commission Approval Of Riders As An Extraordinary Cost Recovery Mechanism.

The AG argues that Illinois courts decisions prohibit the approval of Rider SMP and Rider SEA. One such case is *A. Finkl & Sons Company v. Illinois Commerce Commission*, where the Illinois Appellate Court held that riders are useful in alleviating the burden imposed upon a utility in meeting *unexpected, volatile or fluctuating* expenses. 250 Ill.App.3d 317, 327, 620 N.E.2d 1141 (1st Dist. 1993) (“*Finkl*”) (citing *City of Chicago v. Illinois Commerce Comm’n*, 13 Ill.2d 607, 150 N.E.2d 776 (1958)) (emphasis in original). The First District panel also noted that the amount of costs to be recovered through the rider at issue in the case was not significant, and were recoverable through the usual base rate (case) mechanism. *Id.*

In the *Finkl* case, the AG points out that the First District Court reviewed an ICC order that allowed ComEd to recover costs associated with demand-side management programs through a rider, designated Rider 22. AG IB, p. 27; *Finkl*, 250 Ill. App. 3d at 320. In reversing the Commission’s decision, the Court noted that the costs for which the Company sought recovery were ordinary expenses that revealed no greater potential for unexpected, volatile or fluctuating expenses out of the Company’s control than costs incurred in estimating base ratemaking. *Finkl*, 250 Ill. App. 3d at 327. The Court noted that, in contrast, costs not within the control of a utility, such as fuel costs, are permitted rider recovery. *Id.* In addition, the First District panel noted that the amount of costs to be recovered through the Rider 22 was not significant, and were recoverable through the usual base rate (case) mechanism. *Id.*

The *Finkl* criteria enunciated for determining whether a utility expense should be recovered through a rider was affirmed by the Illinois Supreme Court in *Citizens Utility Board v. Illinois Commerce Comm’n*, 166 Ill.2d 111, 651 N.E.2d 1089 (1995) (“*Citizens Utility Board*”). While the Court upheld the Commission’s approval of rider recovery of coal tar clean-up expenses, the Court affirmed the criteria relied upon in *Finkl* for rider recovery of expenses, noting that the coal tar remediation expenses commonly incurred to comply with the mandate of federal and state law are sufficiently volatile and not within management’s control to justify rider recovery.

AG/CUB witness Brosch testified at length about the circumstances that the Commission should consider when deciding whether to adopt any of the proposed riders in this case. AG IB, p. 28. He stated that costs or revenue changes to be tracked through a rider should generally have *all* of the following characteristics to merit the exceptional and preferential treatment inherent in riders:

1. Substantial enough to have a material impact upon revenue requirements and the financial performance of the business between rate cases.
2. Beyond the control of management, where utility management has little influence over experienced revenue or cost levels.
3. Volatile in amount, causing significant swings in income and cash flows if not tracked.
4. Straightforward and simple to administer, readily audited and verified through expedited regulatory reviews.
5. Balanced, such that any known factors that mitigate cost impacts are accounted for in a manner that preserves test year matching principles.

AG/CUB Ex. 1.0 at 15, 16. The AG points out that the Commission has employed the “large” and “volatile” criteria in resolving rider cost tracking issues in its Order in Commonwealth Edison’s last rate case, Docket No. 05-0597. Final Order, ICC Docket No. 05-0597, p. 212; AG IB, p. 28. In Docket No. 05-0597, ComEd sought to expand the scope of its existing environmental cost recovery Rider ECR, to include more than manufactured gas plant (“MGP”) remediation costs. Final Order, ICC Docket No. 05-0597, p. 204-212. At page 212 of its Order, the Commission stated:

Based on ComEd’s own graph (Exhibit 44.0 – Attachment 1) and the testimony of ComEd’s own witness, the non-MGP costs are not as large or as volatile as the MGP costs. The Commission agrees with Staff that the Company has failed to demonstrate that non-MGP cost are reasonable, prudently incurred, related to delivery costs and are as volatile as MGP costs. The Commission also notes that there is no precedent for recovery of non-MGP costs through a rider. The Coal Tar Cases only involved costs related to MGP sites. Therefore, the Commission rejects the inclusion of non-MGP costs in the proposed Rider ECR.

Id. Both Staff witness Mike Luth and AARP witness Ralph Smith likewise agreed that these characteristics are the basic criteria to be applied when assessing whether rider recovery is appropriate. ICC Staff Ex. 11.0, p. 12-13; AARP Ex. 1.0, p. 5, 8.

Based on this, the AG argues that any adopted rate tracker rider should be straightforward and simple to administer, readily audited and verified thorough expedited regulatory reviews. AG IB, p. 29. Further, AG/CUB witness Brosch stated that any approved rider must be carefully balanced and not distortive of test period relationships – accounting for any known factors that mitigate impacts in a manner that preserves test year matching principles. *Id.*

Applying these criteria to the Companies’ SMP and SEA rider proposals, it is apparent to the AG that neither qualifies for the unorthodox ratemaking treatment riders engender and has not met its burden of proving that extraordinary rider treatment of infrastructure investments and storm expenses outside of normal rate cases is needed. *Id.*

4. The Companies’ Rider Proposals Violate the Public Utilities Act’s Prohibition Against Single-Issue Ratemaking.

The AG cites to the rule against single-issue ratemaking as another basis for rejecting Riders SMP and SEA. AG IB, p. 29. This is a ratemaking principle which recognizes that the revenue requirement formula is designed to determine a utility’s revenue requirement based on the utility’s aggregate costs and demand. *Citizens Utility Board*, 166 Ill.2d at 136, 137; *BPI II*, 146 Ill. 2d at 244. The rule prohibits the Commission from considering changes to components of the revenue requirement in isolation. *Id.* Consideration of one item in the revenue formula in isolation risks understatement or overstatement of the revenue requirement. *Id.* The AG cites to the Illinois Supreme Court, which, in addressing the issue of single-issue ratemaking in *BPI II*, stated:

The rule against single-issue ratemaking recognizes that the revenue formula is designed to determine the revenue requirement based on the *aggregate* costs and demand of the utility. Therefore, it would be improper to consider changes to components of the revenue requirement in isolation. Often times a change in one item of the revenue

formula is offset by a corresponding change in another component of the formula. For example, an increase in depreciation expense attributable to a new plant *may* be offset by a decrease in the cost of labor due to increased productivity, or by increased demand for electricity. ...In such a case, the revenue requirement would be overstated if rates were increased based solely on the higher depreciation expense without first considering changes to other elements of the revenue formula. Conversely the revenue requirement would be understated if rates were reduced based on the higher demand data without considering the effects of higher expenses.

BPI II, 146 Ill.2d at 244-45.

The AG also relies on *Citizens Utility Board*, where the Court concluded that rider recovery of coal tar expenses did not violate the rule against single-issue ratemaking, because such expenses were incurred by federal mandate, have historically been recoverable from ratepayers, and the Commission's approval of a rider for the coal tar clean-up expenses occurred outside of a general rate case. *Citizens Utility Board*, 166 Ill. 2d at 137-38. Given the fact that this docket *is* a general rate case, the AG strongly argues that the *Citizens Utility Board* holding demands consideration and application of the single-issue ratemaking argument.

In the case of *City of Chicago v. Illinois Commerce Comm'n*, 281 Ill.App.3d 617 (1st Dist. 1996) (*City of Chicago II*), the First District Appellate Court upheld the Commission's approval of a separate line-item charge for franchise fees to be charged to the residents of the municipalities assessing the fees and removing them from base rates. The Court cited the aforementioned *Citizens Utility Board* case: "The rule (against single-issue ratemaking) does not circumscribe the Commission's ability to approve direct recovery of unique costs through a rider when circumstances warrant such treatment." *City of Chicago II*, 281 Ill. App. 3d at 628 (quoting *Citizens Utility Board*, 166 Ill.2d at 138. Those "circumstances," in both the *City of Chicago II* ruling and the *Citizens Utility Board* decision, involved either the recovery of unexpected, volatile or fluctuating expenses, pursuant to *Finkl*, or direct recovery of a particular cost *without direct impact on the utility's rate of return*. *City of Chicago II*, 281 Ill.App.3d at 628-629; *Citizens Utility Board*, 166 Ill. 2d at 1102-1103 (emphasis added). Unlike the franchise fees that were the subject of the *City of Chicago II* ruling, both the capital costs of new plant investment and storm expenses can impact a utility's rate of return. AG IB, p. 31. In *City of Chicago II*, the Court highlighted the fact that the Commission's decision to remove local franchise fees from base rates when only customers who resided in the municipality charging the fee were assessed and benefited from the charge was supported by substantial evidence. *City of Chicago II*, 281 Ill.App.3d at 625-626.

Exceptions to the rule against single-issue ratemaking have also been created by legislative mandate. AG IB, p. 31. The General Assembly codified three exceptions to the prohibition against single-issue ratemaking, including (1) fuel adjustment clause riders permitted under Section 9-220 of the Act; (2) environmental remediation fee riders permitted under Section 9-220.1 of the Act; and (3) specifically identified water and sewer expenses under Section 9-220.2 of the Act. See 220 ILCS 5/ 9-220, 9-220.1, 9-220.2.

Accordingly, based on the case law and statutory authorizations issued to date, Commission decisions implementing riders for the recovery of certain expenses have not been

reversed by Illinois courts as illegal single-issue ratemaking when the expenses at issue are (1) unexpected, volatile or fluctuating, pursuant to *Finkl* and the 1958 *City of Chicago* case, or (2) imposed on the utility by law, including federal and state law (such as environmental clean-up expenses) and municipal ordinance for a unique purpose (such as franchise fees), pursuant to the *Citizens Utility Board* and *City of Chicago II* cases, or (3) specifically authorized by statute. Capital costs of new plant additions and storm expenses fall into none of these categories. AG IB, p. 32. In presenting their Rider SMP and SEA proposals, the AG points out that ComEd has ignored the prohibition against single-issue ratemaking and should be rejected. *Id.*

5. The Company's Rider Proposals Violate the Requirement in the Public Utilities Act That Rates Be Least-cost.

The AG points to the fact that the PUA makes multiple references to the mandate that utility rates be least-cost. AG IB, p. 32. Section 1-102 of the Act states that “the General Assembly finds that the health, welfare and prosperity of all Illinois citizens require the provision of adequate, efficient, reliable, environmentally safe and least-cost public utility services at prices which accurately reflect the long-term cost of such services and which are equitable to all citizens.” 220 ILCS 5/1-102. The General Assembly further defined “efficiency” as “the provision of reliable energy services at the least possible cost to the citizens of the State”. 220 ILCS 5/1-102(a). Section 8-401 requires every public utility subject to the Act to provide service and facilities which are in all respects adequate, efficient, reliable and environmentally safe and which, consistent with these obligations, constitute the least-cost means of meeting the utility's service obligations. 220 ILCS 5/8-401.

Illinois Courts' interpretation of the PUA rate making process, as well as the establishment of “just and reasonable” rates pursuant to 9-201 of the Act, reflects this least cost concept. AG IB, p. 33. The Illinois Supreme Court has held that the fixing of just and reasonable rates “involves a balancing of the investor and the consumer interests.” *Illinois Bell Telephone Co. v. Illinois Commerce Comm'n*, 414 Ill. 275, 287, 111 N.E.2d 329 (1953), quoting *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944). Similarly, the Illinois Supreme court earlier established that a just and reasonable rate must be less than the value of the service to consumers. *State Public Utilities Comm'n ex rel. City of Springfield v. Springfield Gas & Electric Co.*, 291 Ill. 209, 216, 125 N.E. 891 (1919). The appellate court elaborated on this pronouncement in *Camelot Utilities, Inc. v. Illinois Commerce Comm'n*, 51 Ill.App.3d 5, 10, 365 N.E.2d 312 (1977), wherein the Court declared that it is the ratepayers' interest which must come first:

“The Commission has the responsibility of balancing the right of the utility's investors to a fair rate of return against the right of the public that it pays no more than the reasonable value of the utility's services. While the rates allowed can never be so low as to be confiscatory, within this outer boundary, if the rightful expectations of the investor are not compatible with those of the consuming public, it is the latter which must prevail.”

Id.

Based on these long-standing legal principles, the AG argues that ComEd's Rider SMP and SEA proposals violate the “least-cost” principle set forth in the Public Utilities Act because “[t]hey constitute illegal, piecemeal rate adjustment mechanisms for isolated elements of the

ComEd revenue requirement after rates have been set in this rate case.” AG IB, p. 33. The AG thus requests that Riders SMP and SEA should be rejected on these grounds as well.

6. The Company’s Rider Proposals Violate the Public Utilities Act’s Prohibition Against Retroactive Ratemaking.

Another reason that the AG asserts as justification for rejection of Riders SMP and SEA is PUA Section 9-201, which ensures that rates for utility service are set prospectively. AG IB, p. 34; 220 ILCS 5/9-201. The Illinois Supreme Court has held repeatedly that the Public Utilities Act does not permit retroactive ratemaking; thus, once the Commission establishes rates, the Act does not permit refunds if the established rates are too high, or surcharges if the rates are too low. AG IB, p. 34 (*citing BPI I*, 136 Ill.2d at 192; *Citizens Utilities Co. v. Illinois Commerce Comm’n*, 124 Ill. 2d 195, 207; 529 N.E.2d 510 (1988) (“*Citizens Utility Co.*”)).

The AG asserts that the rule prohibiting retroactive ratemaking is consistent with the prospective nature of the Commission’s legislative function in ratemaking. In addition, this rule promotes stability in the ratemaking process. *Citizens Utility Co.*, 124 Ill.2d at 207. As the Court noted:

The prohibition of retroactive ratemaking is derived from the overall scheme of the Act and the role of the Commission in the ratemaking process. The rule prohibiting retroactive ratemaking is consistent with the prospective nature of legislative activity, such as that performed by the Commission in setting rates. Moreover, because the rule prohibits refunds when rates are too high and surcharges when rates are too low, it serves to introduce stability in the ratemaking process.

Id. The AG points out that ComEd’s two rider proposals also violate the prohibition against retroactive ratemaking by permitting monthly and annual rate adjustments after rates are established in this case, neither of which are contemplated by the Public Utilities Act or Illinois case law. AG IB, p. 34.

7. ComEd’s Rider Proposals Violate the Commission’s Test Year Rules.

The AG argues that approval of Rider SMP and Rider SEA violates the Commission’s test year rules. AG IB, p. 34. The process used to evaluate and measure the cost of service and resulting revenue requirement is the rate case, in which a balanced review of jurisdictional expenses, rate base investment, the cost of capital and revenues at present rates can be undertaken at a common point in time referred to as a test period or test year. *Id.* at 34-35; AG/CUB Ex. 1.0 at 5; *see also BPI II*, 146 Ill.2d at 238.

In order to accurately determine the utility’s revenue requirement, the AG states that the Commission established filing requirements under which a utility must present its rate data in accordance with a proposed one-year test rule. AG IB, p. 35. Section 287.20 of the Commission’s rules provides that a utility may, at its option, propose either an historical or a future test year. 83 Ill. Admin. Code 287.20. The purpose of the test-year rule is to prevent a

utility from overstating its revenue requirement by mismatching low revenue data from one year with high expense data from a different year. *BPI I*, 136 Ill.2d at 219.

Based on this, the AG argues that the terms and conditions laid out in Riders SMP and SEA would permit piecemeal rate increases for discrete expense items without examining what is happening to other expense and revenue components of a utility's revenue requirement, which is inconsistent with the test year rule upheld by Illinois courts. AG IB, p. 35. This ratemaking precept is yet another reason to reject ComEd's rider proposals. *Id.*

B. Rider SMP

1. Summary of ComEd Rider SMP Proposal

ComEd's proposed Rider SMP tariff is described in detail in ComEd Ex. 30.1 and discussed in the testimony of several ComEd witnesses. According to ComEd witness J. Barry Mitchell, President and Chief Operating Officer of the Company, Rider SMP will provide for recovery of the revenue requirement equivalent (recovery of and return on) of the investment costs of a limited number of capital projects "solely or primarily dedicated to improving the distribution system to enhance service to retail customers, improvements beyond ComEd's basic service obligation." ComEd. Ex. 1.0, p. 10. According to Mr. Mitchell, "Very simply, this approach will allow ComEd to invest in advanced technological enhancements to the grid which, although desirable, are not immediately required to provide safe, adequate and reliable service." ComEd Ex. 1.0, p. 11. Among the advanced technologies referred to for future Rider SMP treatment are so-called "Smart Grid" investments, which ComEd defined as technologies that "will empower consumers with information and support intelligent choices about energy use, as well as enhance reliability and customer service." ComEd Ex. 14.0, p. 3.

The AG states that a critical fact in evidence for Commission consideration of the Rider SMP proposal is the Company's pronouncement that the projects that would be financed by Rider SMP are not necessary for the provision of reliable electric delivery service. AG IB, p. 36. Susan Tierney, ComEd's outside expert, stated:

"Put simply, ComEd's proposal for the SMP Rider is a creative mechanism for funding *discretionary* projects that have the potential – if justified before the Commission – to create value to consumers but which *are not* 'necessary' for the provision of safe, reliable, efficient distribution service."

ComEd Ex. 18.0, p. 16 (emphasis added). ComEd views Rider SMP as the cost recovery mechanism for projects that "reflect ComEd's current vision for a distribution system of the future." ComEd Ex. 14.0. Accordingly, Rider SMP will trigger quarterly rate increases to cover a return of and on plant that is admittedly not necessary for the provision of safe, reliable, efficient distribution service. AG IB, p. 36.

In its proposed form, the AG argues that any growth in spending on approved SMP projects translates directly into higher future prices for consumers. *Id.* These line-item rate increases would occur outside of a rate case, with cost recovery computed each month based on

actual incremental capital investments from the last calendar quarter. *Id.* Rider SMP adjustments would apply to all retail customers, and would be imposed as a “percentage of other charges” instead of on a kWh basis as initially proposed. ComEd Ex. 30.1, 1st Revised Sheet No. 626. The AG points out that ComEd’s proposed rider approach to financing its new capital investment would enable the Company to achieve a Commission declaration that the proposed plant investment is used and useful and prudently incurred *before* the Company spends a dollar on the proposed capital addition. AG IB, p. 37. ComEd would achieve this preferential ratemaking treatment without having to account for generalized productivity growth, any specific cost savings associated with such higher capital spending and any other changes in its revenue requirements. *Id.* ComEd witness Mitchell confirmed that Rider SMP would be in place as a cost recovery tool “indefinitely.” Tr. at 80.

ComEd witness Crumrine states, “The intent of this rider is to treat the capital costs of these projects in a similar manner as the Commission would in a rate case, but with more timely recovery between rate cases.” ComEd Ex. 11.0, p. 17. As noted by AG/CUB witness Brosch, however, this more “timely” recovery simply means that ratepayers pay higher prices sooner than would occur under traditional test period regulation, with ratepayers assuming the risk of investing prudently normally borne by the Company and its shareholders. AG/CUB Ex. 1.0 at 19. ComEd estimates annual Rider SMP capital investment ranging from \$28.9 million in 4th Quarter, 2008 to \$294 million in 2010, and then \$250 million in 2012. ComEd Ex. (corrected) 43.1 at 2. These figures translate into annual revenue requirement figures of \$9.6 million in 2009 to \$120 million in 2012, over and above the overall revenue increase granted by the Commission in this case. *Id.*

After Staff and Intervenor witnesses registered various objections -- both on legal and factual bases -- to the Company’s specific Rider SMP project proposals, the Company withdrew its request for Rider SMP treatment of seven projects, including Advanced Metering Infrastructure (“AMI”), which ComEd states serves as the basis for future Smart Grid investment. AG IB, p. 37. Thus, ComEd is requesting Commission approval of Rider SMP with no specific projects or capital additions attached to the rider. Tr. at 83-84. Included in this request is a specific schedule for biannual workshops and docketed proceedings that ultimately would result in Commission approval of specific, ComEd-proposed Rider SMP projects through a six-month proceeding beginning in May of 2009. *Id.* The AG points out that even under ComEd’s revised proposal, ComEd would still obtain a specific Commission declaration that the projects to be financed through Rider SMP are both prudent and used and useful. *See* ComEd Ex. 43.0, 5-7; Tr. at 95. The Company proposes an annual reconciliation proceeding, in which the Commission would examine the reasonableness of Rider SMP project costs. *Id.* In this docketed proceeding, the Commission would also review ComEd’s earnings to determine whether Rider SMP refunds are in order (not to exceed the amount of SMP surcharges) if it is determined that Company’s reported earnings exceeded the rate of return established in the last rate case. Tr. at 1920.

1. The Record Evidence Fails To Justify Commission Approval of Rider SMP.

a. Rider SMP Fails the General Criteria Routinely Relied Upon By Regulators To Evaluate Riders.

AG/CUB witness Brosch states that Rider SMP fails every one of the general criteria that are routinely relied upon by regulators to evaluate rider proposals and highlighted by Illinois courts as appropriate for rider recovery. AG IB, p. 38. The costs associated with return on and return of SMP capital investments (return and depreciation) are:

- Not large in relation to the overall revenue requirement;
- Not volatile in amount; and
- Not beyond the control of utility management.

AG/CUB Ex. 1.0 at 32. An example of this can be seen in ComEd's revenue requirement amounts, where the level estimated by ComEd is not significant to ComEd's future financial stability. Projected Rider SMP amounts represent only 0.4 percent in 2009, growing ultimately to about 4.1 percent of the Company's total \$2.2 billion revenue requirement. AG/CUB Ex. 1.0, p. 32-33. The AG argues that after five years without a rate case to evaluate overall earnings and revenue requirement, it would be wholly inappropriate for customers to be charged \$120 million through Rider SMP in 2012, for example, for piecemeal technology investments with no accounting for cost savings and other benefits enabled by such technology. AG IB, p. 39.

Another problem with Rider SMP are the carrying costs (return and depreciation), which are not volatile in amount, such that traditional test year ratemaking cannot reasonably quantify and account for such costs. *Id.* As noted by AG/CUB witness Brosch, Rider SMP is designed to account for modest and gradually increasing carrying costs associated with a multi-year program of planned technology investment. AG/CUB Ex. 1.0 at 33. These costs do not fluctuate from month to month, but are instead expected to slowly and gradually ramp up as planned capital investments are made. ComEd Ex. 43.1, 2. Unlike a utility's purchased power or purchased gas expenses that are incurred in commodity markets where prices can fluctuate significantly, the carrying costs on proposed SMP projects are not unpredictable or volatile and need not be recovered through an extraordinary rider. AG IB, p. 39.

ComEd maintains complete ability to control and prioritize capital spending, which is a key factor in determining whether rider recovery is appropriate, according to the Commission and Illinois courts. AG IB, p. 39. Under the regulatory process proposed, ComEd has sole discretion as to what projects will be proposed to the Commission for Rider SMP treatment. Tr. at 430, 1042. Accordingly, the AG argues that ComEd's capital costs for SMP projects are in no way, shape or form "beyond the control of management." *Id.* at 40. On this criterion, too, the AG asserts that Rider SMP costs fail the test applied by both the Commission and Illinois courts for permissible rider recovery. *Id.*

b. The Evidence Shows Rider SMP Is Not Needed To Fund New Delivery Service Investment.

The AG states that to date, ComEd has successfully modernized its network and, generally speaking, maintained reliability over the years, without benefit of an automatic rider recovery mechanism for distribution system modernization projects. AG IB, p. 40. ComEd

witnesses assert that it has been investing hundreds of millions of dollars in new plant every year in the normal course of business. Tr. at 444. As ComEd stated in response to AG data request 2.25, “To date, ComEd has not failed to make any investment required to meet its service obligations to its customers because of the absence of a mechanism like Rider SMP.” AARP Ex. 1.0, p. 13.

ComEd’s gross construction expenditures in 2006, all of which were incurred without advanced Commission approval or guidance, were more than \$910 million. Tr. at 445. ComEd witness Mitchell admitted that what ComEd seeks through its Rider SMP proposal is assurance of recovery of prudently incurred costs. Tr. at 95. He went on to disclose that Rider SMP “. . . wouldn’t change really anything with respect to how we finance projects” because the Company would continue to use internally generated funds and issue debt. Tr. at 80-81. Thus, the AG claims that Rider SMP is not about ComEd needing extra money to finance the proposed investments.

The AG also points to financial evidence presented by ComEd as part of its Part 285 filing in this case as proof that extraordinary rider treatment is not needed to finance new plant investment. AG IB, p. 40. For example, a review of ComEd’s historical Comparative Financial Data on Schedule D-7 reveals persistently positive Operating Income and sufficient cash flow captioned “Total Funds from Operations” from 2002 through 2006 at levels that have allowed ComEd to finance most or all of its “Gross Construction Expenditures” with internally generated Net Cash Flows. *See* Schedule D-7 at lines 9, 39, 59 and 61.

The AG points to the testimony of Staff witness Mike Luth, who testified that it does not appear that system modernization investments would cause more of a “regulatory lag” concern than other more typical capital investments. AG IB, p. 41. Luth’s calculations show that average estimated or proposed system modernization investments for the years 2009 through 2013 are only about 23 percent of the average amount that ComEd capitalized for standard or typical installations in the years 2001 through 2007. ICC Staff Ex. 11.0 at 9. He noted that the cost of standard or typical installations in the years 2001 through 2007 were more than four times ComEd’s estimate of SMP costs in the years 2009 through 2013, which excludes the effect of inflation, if any, on standard or typical projects not recoverable through proposed Rider SMP from the years 2001 through 2007. *Id.* These figures, the AG argues, do not suggest rider treatment is needed to fund new, innovative plant additions. *Id.*; AG IB, p. 41.

AG/CUB witness Brosch noted that ComEd’s projected SMP revenue requirement impacts represented only 0.4 percent in 2009, growing ultimately to about 4.1 percent of the Company’s total \$2.2 billion revenue requirement. AG/CUB Ex. 1.0 at 32. These costs, he concluded, are not sufficiently large to merit extraordinary rider recovery. *Id.*; AG IB, p. 41.

The AG points to evidence that shows that ComEd can still invest in Smart Grid technologies if it deems the investment worthwhile and cost-efficient. AG IB, p. 42. ComEd stated, “Rider SMP would allow ComEd to make specific capital investments that *might not otherwise be made at the levels and in the time frames included in ComEd’s base forecast*, because of the financing decisions described above [emphasis added].” AG/CUB Ex. 3.0 at 5; AG/CUB Ex. 3.1. Also, ComEd Chief Operating Officer Mitchell stated that he hesitates to say

the company never would make an investment in AMI absent Rider SMP. Tr. at 74. Mr. Mitchell admitted that the Company would return to its normal capital budgeting process to determine when and if it will invest in AMI, applying “the same kinds of standards that we always would” if the Commission denied Rider SMP, just as it would with the other proposed Rider SMP projects. Tr. at 74-76. He also stated that AMI technology could be implemented in different phases but did not specify a specific timeline. Tr. at 76-77.

c. The Alleged Benefits Derived From Rider SMP Approval Amount To
Nothing More Than A Shift of Investment Risk From Shareholders to
Ratepayers.

The AG claims that Rider SMP is an inappropriate attempt to shift risks traditionally borne by the shareholders onto ratepayers. AG IB, p. 42. To establish this, the AG points to several ComEd statements as support of this notion. *Id.* ComEd COO Mitchell characterizes the SMP proposal as creating “a ‘partnership’ between ComEd and the Commission that will enable ComEd to move towards a more modern system and to incorporate into its grid the kinds of technologically advanced features that will help our customers revolutionize the ways they manage their electric usage.” *Id.*

However, the AG asserts that ratepayers will be denied most of the payback associated with the cost savings to be achieved by the investments while nevertheless incurring monthly SMP surcharges. AG IB, p. 43. AG witness Brosch points out that a key feature of Rider SMP is the shifting of all risks associated with capital investment optimization decisions from ComEd and its shareholders toward the Commission and ratepayers. *Id.* The AG believes that the “partnership” that is said to “enable ComEd” to invest more rapidly and aggressively in optional technologically advanced features is little more than an invitation for regulators to commit ratepayers’ funds in advance, eliminating any risk to shareholders that the pre-approved amounts invested will ever be found excessive, unreasonable or imprudent. *Id.*; AG/CUB Ex. 1.0 at 36.

Mr. Brosch points out that the utility has always maintained the management expertise, in depth technical information, financial resources and clear responsibility to make optimized capital investment and technology deployment decisions. *Id.* Based on this, the AG asserts that it is unreasonable and improper to excuse management from this responsibility by merely presenting proposed project information to the Commission and its Staff as part of an SMP approval process. AG IB, p. 43.

ComEd has insisted that it would decide under its proposal exactly what it will propose for Rider SMP treatment, regardless of what was recommended or debated in any Rider SMP workshop. *Id.* This can be seen at the January 7, 2008 informal meeting and additional time the Company needed to refine its Rider SMP project proposals. *See* ComEd Motion for Leave to File Supplemental Testimony, filed December 20, 2008. ComEd heard the opposition to the proposed Rider SMP process at the January meeting, including stated concerns from Staff, CUB and OAG representatives about the legality of a Rider SMP, as well as concern as to how the Company defined “Smart Grid” technologies and whether the proposed projects fit into a Smart Grid definition. AG IB, p. 44. The Company went ahead and proposed in its February

Supplemental Direct testimony the same projects it presented to Staff and Intervenor on January 7, 2008, despite their objections. *Id.*

Additionally, during cross-examination, ComEd pointed out that the decision as to what would be proposed at the end of the formal six-month docketed proceedings would remain with the Company, and that ComEd would not wait for any kind of consensus before presenting a Rider SMP project proposal after the proposed six-month workshop process. Tr. at 430, 1042.

The AG argues that it is not clear what gains ratepayers will obtain from Rider SMP, besides additional surcharges each month because, while the Company implies that Rider SMP is needed if investment in Smart Grid technology will occur, it also asserts that it would still invest in such technology, albeit at a slower pace. AG IB, p. 44.

The AG states that while technological innovations generally can provide customer benefits, the benefits must be weighted against the cost of making the investment, and the requirement that utility rates be least cost. AG IB, p. 44; *See* 220 ILCS 5/1-102, 1-102(a), and 8-401. The Company has stated that it has conducted no marketing studies to gauge customer interest in the advanced metering services that would be provided by AMI technology. Tr. at 166-167. Without such information about customer interest in the information and services supplied by AMI technology, the AG states that it is difficult to offer reliable conclusions about discrete customer benefits. AG IB, p. 45.

d. Rider SMP Fails To Account For Cost Savings That Would Be Achieved By Investment in the Proposed Projects, In Violation of the Act's Prohibition Against Single-Issue Ratemaking.

ComEd asserts that one of the benefits associated with investment in capital projects proposed for Rider SMP treatment is the significant operations and maintenance (O&M) savings that are expected to occur as a result of the investment. AG IB, p. 45. ComEd estimates annual potential savings associated with full deployment of AMI investment of about \$73.5 million. ComEd Ex. 23.0, p. 14. These savings from full deployment of AMI investment are generated from several sources, according to ComEd. For example, ComEd estimates AMI would:

- permit remote disconnect of electric delivery service, resulting in savings in reduced uncollectibles of \$9.1 million annually (Tr. at 208);
- generate the potential reduction in purchased energy of \$62.4 million annually (ComEd Ex. 23.0 [Clair] at 16-17, Tr. at 215); and
- result in annual delivery service O&M savings to the Company of about \$15.6 million (Tr. at 216).

ComEd also estimates that it could avoid another \$24.4 million in purchased energy costs associated with AMI detection of meter tampering, translating into additional O&M savings of about \$6.1 million (Tr. at 217-218), and create potential un-metered energy cost savings of \$8.6 million as a result of increases in billed energy usage due to increased accuracy of solid-state meters vs. current electromechanical meters, as well as the elimination of stuck meters with the new solid-state AMI meters. ComEd Ex. 23.0, p. 17.

ComEd witness Clair also listed 10 types of “system benefits”, which may result in O&M savings that would result from AMI deployment. ComEd Ex. 23.0 (Clair) at 18-23. These, she stated, are additional benefits that the Company has not yet quantified. Tr. at 218. Moreover, the Company estimates an additional \$10.4 million in savings would occur solely during the AMI implementation period. Tr. at 214-215. Ms. Clair added that a more certain level of savings amounts could not be calculated until Phase 0 of AMI investment is conducted. Tr. at 211. She also stated that Phase 0 might identify additional costs and benefits. Tr. at 220-221. Mr. Williams testified that when an investment in the distribution system is effective at reducing restoration times, avoidance of maintenance costs associated with ComEd’s field personnel is achieved. Tr. at 698-699.

The AG takes issue with the fact that the proposed Rider SMP tariff fails to offset or reduce surcharges generated by Rider SMP projects with achieved O&M savings related to the investment, leaving Rider SMP hopelessly piecemeal and one-sided. AG IB, p. 46. Thus, the AG argues that Rider SMP’s design will guarantee customers are overcharged between rate cases though monthly rider surcharges because they will pay the full carrying costs (return of and on) the new SMP investments while O&M expense savings are retained by investors. *Id.* This, the AG states, is patently unfair and constitutes another violation of the Act’s prohibition against single-issue ratemaking. *Id.*

AG/CUB witness Effron argues that the Company’s proposal to create a regulatory asset (ComEd Ex. 25.0 at 77-80) and reflect recovery via amortization in Rider SMP does not address in any way the income tax impacts of abandoning these existing meters. AG/CUB Ex. 4.0 at 21. A comparison conducted by Mr. Effron of the project capital expenditures associated with AMI deployment reveals that AMI outlays will be concentrated in the 2010-2013 time frame, according to ComEd’s Rebuttal workpapers. AG/CUB Ex. 4.0 at 22. ComEd’s workpapers show anticipated costs savings and revenue gains associated with that investment ramping quickly after the concentration of spending in the early years. AG IB, p. 46. The AG argues that this significant jump in anticipated O&M savings and revenue gains indicates a serious deficiency in Rider SMP charging ratepayers for the increasing capital expenditures, while leaving the O&M savings for the benefit of shareholders. *Id.*

The AG notes that traditional regulation is better than the flawed as the Rider SMP process because all of the Company’s rate base investments, expenses and revenues are subject to review, forcing the Company to account for all changes in O&M that occurred as a result of new capital investment. AG/CUB Ex. 1.0 at 24. ComEd witness Terrence Donnelly concurred during cross-examination that traditional regulation and test year data will reflect realized O&M savings at the same time new investment is included in rate base. Tr. at 447-449.

e. ComEd’s Traditional Capital Budget Process and the Test Year Filing Requirements Best Ensure That the Company Prudently Plans and Manage Plant Addition Costs and That Customer Rates Reflect Only the Cost of Utility Plant That is Used and Useful.

ComEd currently is responsible for prioritizing and optimizing capital investment decisions. Tr. at 90. ComEd’s existing capital budget process has enabled it to prudently and

efficiently invest in new technology that increased the reliability of the delivery system and offered new and innovative services without extraordinary rider recovery of the financing of those investments. AG IB, p. 48. AG Cross Ex. 4 details the process and its many layers of approval required within the Company and its Board of Directors before discrete projects are approved. ComEd's Senior Vice President of Operations, George Williams, stated ComEd's capital additions process requires large capital investments to follow extensive approval procedures to ensure technical justification and economic optimization. ComEd Ex. 4.0, p. 52. ComEd's budget process begins in March and it takes nearly a year to complete. Tr. at 91.

Williams explained that while all investments are managed to keep costs down, major investments are subject to a vigorous and formal "challenge" process that ensures there has been fully informed decision-making, particularly with respect to refining scope and eliminating unnecessary costs. ComEd Ex. 4.0, p. 52. ComEd concluded that the challenge process helps the company make intelligent, reasonable and prudent investment decisions. Tr. at 727. ComEd employs a "self-critical" approach to capital investments. Tr. at 727-728. The Company includes this "self-critical approach" to its capital budget process because it believes it is the best way to make prudent, reasonable investments. Tr. at 728. It is not until late August that an initial draft of the O&M and capital expenditure budget is compiled and reviewed with ComEd's operating leadership. Ultimately, in early December, ComEd's CFO presents to ComEd's board of directors the business plan for the upcoming year, which includes a summary of the capital expenditures budget. Tr. at 91. Changes are incorporated in late December and early January. Tr. at 91; AG Cross Ex. 4.

The AG argues that ComEd's proposed Rider SMP projects were not and would not be subject to this extensive, self-correcting budgeting process that, according to ComEd's own witnesses, ensures that only prudent investment decisions are made. Tr. at 94; 203-204, 205.

f. The Uncertainties Surrounding AMI and Other Proposed Rider SMP Projects Support Commission Rejection of Rider SMP.

ComEd withdrew its specific Rider SMP project proposals in this docket and the AG states that the Commission is left with the task of determining whether to approve a rider based on ComEd's discussion of what might be. AG IB, p. 50. This lack of specific information is important to the AG. *Id.* A reason why Rider SMP should not be approved, according to the AG, is the lack of *specific* information about the costs and benefits of Rider SMP projects referenced in the case. *Id.* The AG states that cost information about the primary focus of the Rider SMP proposal -- AMI investment -- is only at the RFI, or Request for Information, level. *Id.* ComEd witness Clair testified that before investments are made, an RFP, or Request for Proposal, must be submitted. Tr. at 197. According to Clair, this process "takes it kind of to the next level and starts to get a little more solid foundation." Tr. at 197. Vendors, she indicated, provide a more "granular" or specific level of detail about cost levels for particular projects in the yet-to-be-issued RFPs. Tr. at 197-198.

Clair testified that AMI is composed of three components: the meters and associated communication network, the meter data management system, and the integration into other ComEd Information Technology ("IT") systems. ComEd Ex. 23.0, p. 8. The \$600 million to

more than \$1 billion AMI costs estimate listed in Clair's rebuttal testimony, however, only included that first component of AMI – meters and associated communication network. Tr. at 200. Neither the meter data management system nor the integration into other ComEd IT systems components are included in this AMI cost estimate obtained from the latest RFI. Tr. at 200-201. In an updated capital budget provided in ComEd Ex. 43.1, page 1, the Company lists the cost of AMI technology investment from 2008 through 2013 to be \$891,560,000. Clair confirmed that the Company could, in no way, guarantee that that amount would not change. Tr. at 198, 207-208. He states that ratepayers would be charged a return of an on the investment made in Phase 0 before there was a determination that Phase 0 had been successful. Tr. at 204.

The AG claims that the alleged benefits of AMI technology are an even more amorphous basis for approving Rider SMP. AG IB, p. 51. ComEd conducted no market research studies to gauge customer interest in the services that would be provided by AMI. Tr. at 78-79. ComEd consultant and witness Stephen George presented estimates of the potential demand response benefits that could be obtained if ComEd is allowed to deploy AMI and he testified that he did not survey any ComEd bundled or unbundled customers for purposes of any of his conclusions in his testimony. ComEd Ex. 31.0, p. 1; Tr. at 166-167.

Despite the lack of market research, ComEd is requesting RFIs that incorporate AMI components and add expense to a bid. AG IB, p. 51. Typical smart grid components include a service or services known as "Home Area Network" ("HAN"), which according to ComEd witness Clair, is technology that enables devices within the house, such as appliances, to provide more electricity usage details. *Id.* This capability would be built into AMI infrastructure and presumably offered as a service to interested ratepayers upon charging ratepayers up front through Rider SMP for AMI investment. Tr. at 190. However, such a service requires customer investment in new appliances that specifically have that capability to indicate usage. Tr. at 191. Mr. Clair confirmed that the smaller the incremental time reading, e.g. 15-minute readings vs. one-hour detail, also adds cost to the technology. Tr. at 193-194. ComEd performed no market demand study to determine whether customers are interested in the HAN aspect of AMI technology, but in the RFI submitted to vendors, the requested presence of a HAN chip that provides the HAN capability increases AMI costs, anywhere from \$16 to \$60 million, depending on which technology is chosen. Tr. at 208-209; AG/CUB Ex. 4.0 at 20. The AG questions the propriety of charging all retail ratepayers for services that only segments of particular customer classes may use. AG IB, p. 52.

The record evidence also shows that Alternative Retail Electric Suppliers ("ARES"), such as Constellation New Energy (CNE) and others seeking to compete in the Chicago area, would gain competitive benefits upon the installation of AMI. *See, gen'ly*, Constellation New Energy Ex. 1.0, 2.0. ComEd witness Clair confirmed ARES would stand to reap many benefits with the investment in certain Rider SMP projects. ComEd Ex. 23.0, p. 20. ARES would also benefit generally from the increased information offerings that come from AMI technology. Tr. at 210. The AG alleges that these facts raise issues of cross-subsidization of potentially competitive services by ComEd's delivery service ratepayers that need to be considered by the Commission before approving a vehicle for automatic monthly rate adjustments to finance SMP investment via Rider SMP. AG IB, p. 52.

The CNE testimony also suggests that ComEd stands to collect additional revenues associated with AMI investment that would not be deducted from any Rider SMP surcharges, raising single-issue ratemaking concerns because new revenues might offset the alleged need for SMP surcharges, which can be prevented by incorporating plant investment is incorporated into rates at the time of a rate case and under the dictates of Section 9-211 of the Act. *Id.*

Other issues that the AG argues require rejection of Rider SMP are that it would require the Commission to approve Rider SMP based on assumed interest in AMI technology, before anyone has even developed evaluation criteria to determine whether Phase 0 has been successful. *Id.* ComEd's proposed Rider SMP process would have the Commission making a determination on initial AMI investment by November 1, 2009, with ComEd then seeking approval for full deployment of AMI. ComEd Ex. 23.0, p. 7.

The AG points to the lack of information regarding customer demand for new AMI-based services and the potential for new revenues and states that the only evidence of customer interest in the kinds of information services AMI would provide is "underwhelming at best." AG IB, p. 53. Additionally, the AG points to the fact that the number of participants in the Company's residential Real-Time Pricing program, which has been offered since 2003, is only 4,902 active participants out of a total of 3.4 million ComEd residential customers for whom this service is available. AG IB, p. 53; Tr. at 711; ComEd Ex. 4.0, p. 6.

The AG argues that the Company's traditional capital budget process and traditional rate case regulation has worked well to ensure that ComEd continues to invest in innovative technology in a prudent and reasonable manner. As support for this, the AG cites to the Company witnesses. AG IB, p. 54. ComEd witness Williams describes the Company's deployment of SCADA technology, "smart" switches and mobile dispatch systems to improve service and reduce expenses. ComEd Ex. 4.0, p. 14-16. Similarly, ComEd witness Mitchell describes the Company's use of aerial spacer cable, dielectric injection treatment of underground cables and other new technologies to improve distribution system performance. ComEd Ex. 1.0, p. 7-8. The AG concludes that if ComEd decides that the benefits reasonably expected from Smart Grid or other new technologies, in the form of improved service quality and/or reduced O&M expenses, are likely to exceed the costs of the technology investment, there is no reason to believe that ComEd would not choose to invest in the technology, albeit at a pace that might be slower than presented by the Company in this docket, or that such investment would not be fully recoverable in future rate cases. AG IB, p. 54.

The AG also asserts that if the Company is uncertain about rate base inclusion of so-called Smart Grid projects due to the untested nature of the technology, then a rider will not ameliorate those technological uncertainties. *Id.* Approval of Rider SMP will simply shift the risk associated with recovery in rates of significant, untested plant investment from shareholders to ratepayers, and require ratepayers to subsidize new investments that the Company admits are not needed for the provision of basic, reliable, safe and least cost utility service. *Id.*

g. Both the Proposed Language and Process of Rider SMP Create Incentives for ComEd To Seek Approval of Ordinary Capital Investment Costs Under Rider SMP.

Another problem that the AG identifies with ComEd's proposal is that it would allow ComEd to seek and obtain approval of ordinary capital investment costs with Rider SMP. AG IB, p. 55. Under ComEd's proposed Rider SMP tariff, any project that "provides improved monitoring or performance of the Company's distribution system" is eligible for Rider SMP treatment. ComEd Ex. 30.1, Sheet 626, Item 5; Tr. at 1044-1045. The AG argues that under this broad standard, any capital investment for which ComEd seeks rate base recovery in this case falls under that category. AG IB, p. 55. For example, the AG states that during cross-examination, every project for which Mr. Williams testified was prudent and reasonably incurred for purposes of rate base inclusion fell into the "provides improved performance of the Company's distribution system." Tr. at 699-716.

However, both Staff witness Luth and AG/CUB witness Brosch agreed that this vague criterion for Rider SMP recovery is too broad, and would invite the Company to finance just about any major project through Rider SMP. AG IB, p. 55. Staff witness Luth, for example, expressed concern that ComEd would view the installation of new equipment meeting current standards or practices as costs that would be recoverable under proposed Rider SMP. *Id.* Under the proposed tariff language, Mr. Luth points out that ComEd could seek rider recovery for any installation of new equipment that would constitute an improvement over used equipment, and still meet the criterion listed for eligible investment under the Rider SMP tariff language. Staff Ex. 11.0 at 4-5.

AG/CUB witness Brosch noted that any expenditure that "automates" or improves the "performance" of the distribution system or is "innovative", "novel" or increases "operational efficiency" can qualify for Rider SMP cost recovery. AG/CUB Ex. 4.0 at 12-13. The AG argues that this defect in the Rider SMP tariff leaves ComEd retail delivery service customers particularly vulnerable to piecemeal rate increases each month for plant that typically is incorporated in rates in a rate case filing. AG IB, p. 55-56.

h. ComEd's Attempt To Model Rider SMP After Part 656, Water And Sewer Utility Qualifying Plant Surcharge, Does Not Cure the Many Practical and Legal Defects of Rider SMP.

Based on recommendations from Staff witness Hathhorn, the Company revised its Rider SMP proposal to adopt provisions similar to Part 656, the Commission's rule codifying Section 9-220.2 of the Act. AG IB, p. 56. Part 656 provides for rider treatment of certain water and sewer plant investments. 83 Ill. Admin. Code Part 656 (AG Cross Ex. 15). The provisions incorporated into the ComEd SMP proposal include capping SMP surcharges at 5% of ComEd revenues, adding a reconciliation filing that would examine the "reasonableness" of SMP costs, and incorporating an earnings test that might generate refunds of Rider SMP surcharges. AG IB, p. 56. ComEd witness Crumrine cites the reference to Part 656 as one reason why the Company should not be required to reflect cost savings associated with SMP investment in the Rider SMP tariff, because "such requirements are not reflected in Part 656. *Id.* The AG strongly suggests that reference to Part 656 is an inappropriate model for proposed system modernization investment rider recovery. *Id.*

The AG understands Staff's interest in improving a deeply flawed proposal in case the Commission inexplicably approves Rider SMP, but argues that the relevance of employing Part 656 as a model for ComEd's Rider SMP is questionable at best. AG IB, p. 56. The AG states that Part 656 was never intended to apply to anything but qualifying water and sewer investment. *Id.* ComEd witness Crumrine agreed that this provision is intended to apply to mundane replacement of utility plant rather than complex technologies and modernization investments, such as Smart Grid technology. Tr. at 1046-1047. Unlike Rider SMP, the qualifying water and sewer infrastructure plant eligible for rider recovery is specifically authorized by statute. Tr. at 1050. In addition, the qualifying plant eligible for Rider QIP (Part 656) recovery must be replacements of existing items from four specific accounts for water utilities and three specific accounts listed for sewer utilities. Tr. at 1050-1051. To qualify for rider treatment under Part 656, water and sewer plant investments must be replacements installed to replace facilities that are worn out or deteriorated, or to replace facilities that are obsolete and at the end of their useful lives due to a change in law or a change in the regulation of a governmental agency. Tr. at 1052. No such restrictions would apply under ComEd's proposed Rider SMP. Tr. at 1052. In fact, the AMI project the Company originally proposed for Rider SMP recovery would replace meters that still have useful lives, are not fully depreciated, and are neither obsolete or worn out. Tr. at 1052.

Part 656.40 qualifies the plant eligible for rider recovery in several additional respects, unlike Rider SMP. AG IB, p. 57. For example, the plant must be non-revenue producing. 83 Ill. Admin. Code Part 656.40(2). No such restriction applies under Rider SMP. In addition, eligible plant under Part 656 must not have been included in the calculation of the rate base in the utility's last rate case. 83 Ill. Admin. Code Part 656.40(5). Mr. Crumrine confirmed that the Company's original Rider SMP proposal would have included AMI infrastructure investment that replaces plant included in the Company's prior rate cases. Tr. at 1053.

AG/CUB witness Brosch testified that ComEd's modification to the SMP tariff, as modeled after Part 656, did not cure the many defects highlighted above of Rider SMP nor adequately protect ratepayers. AG IB, p. 57. He noted that the annual reconciliation proposed, adds administrative complexity and likely future controversy to the administration of Rider SMP, as set forth at Original Sheet 629.8 of the tariff. *Id.*; ComEd Ex. 30.1. Brosch likewise concluded that the 5% cap on Rider SMP surcharges provides ratepayers with no meaningful protection, at least in the short term. AG IB, p. 58. The 5% of revenues figure would cap surcharges at approximately \$85 million annually. *Id.* Given the projected spending levels listed in ComEd witness Crumrine's exhibits, the Company is unlikely to reach such an annual spending level until 2012, and then only if no rate cases are filed. AG/CUB Ex. 4.0 at 37.

Accordingly, the AG argues that the Company's suggestion that the modifications proposed in its Rebuttal case mirroring some of the provisions of Part 656 improve the Rider SMP proposal and justify Commission approval of the rider should be rejected.

i. ComEd's Proposed Earnings Test for Rider SMP Plant Surcharges Neither Protects Ratepayers Nor Cures the Legal Infirmities of Rider SMP.

The AG argues that the proposed earnings test for Rider SMP plant surcharges do not protect ratepayers or cure the legal infirmities of Rider SMP. AG IB, p. 58. ComEd proposed in its rebuttal case incorporating an earnings test modeled after Part 656 that would require the Company to refund some or all of Rider SMP surcharges if it was shown that the Company's actual earnings over the past year exceeded its authorized return established in this rate case. ComEd Ex. 30.0, p. 12. According to ComEd witness Crumrine, this earnings test would protect ratepayers and trigger refunds "to the extent that such revenues contributed to the realization of a rate of return above the last approved level." *Id.* Crumrine cited this earnings test as a reason why it should not be required to reflect cost savings associated with SMP investment through the rider mechanism. *Id.* at 18.

The AG states that during cross-examination of Crumrine, it became apparent that despite his assurances that ratepayers were protected by the proposal, it was clear that Mr. Crumrine had no idea how the Company's earnings would be calculated for purposes of the annual earnings test. He admitted he was not an accountant. Tr. at 1056. He could supply no detail as to whether any known or measurable changes would be incorporated into the calculation for purposes of the review. Tr. at 1055. He had no idea how the rate base would be calculated in the annual earnings test. Tr. at 1055-1056. He could not explain how operating income could be calculated for purposes of the earnings calculation. Tr. at 1058. And, significantly, he did not know whether any abnormal transactions might be included in the calculation of jurisdictional net operating income. Tr. at 1065. Crumrine conceded that whether there are ratemaking adjustments and what those adjustments might be significantly affects the calculation of a company's net operating income. Tr. at 1066.

The AG asserts that how the Company chooses to calculate its rate base and net operating income, and indeed what abnormal transactions are incorporated into the calculation of the Company's return, significantly affects how a reported return is calculated, and accordingly whether ratepayer refunds are deemed necessary and appropriate. AG IB, p. 59. The AG also asserts that Mr. Crumrine testimony makes it clear that any Rider SMP annual reconciliation proceeding can generate significant controversy among Staff, the Company and intervenors in any annual reconciliation proceeding. *Id.*; Tr. at 1066-1067.

ComEd witness Karen Houtsma tried to explain the earnings test but Houtsma admitted that the proposed earnings "cap" for Rider SMP in no way capped earnings and did not refund to ratepayers all revenues that exceeded the Company's most allowed rate of return in the most recent rate order.. Tr. at 1920. The maximum reduction is the amount of SMP revenues in the year being reconciled. *Id.* The earnings test fails to account for changes in market conditions that affect ComEd's cost of equity. Houtsma testified that ComEd would always use the last approved rate of return as a benchmark for purposes of the Rider SMP earnings test. Tr. at 1929. However, if ComEd's cost of debt declines in future years as a result of improved credit metrics or refinancing of long-term debt, the earnings test calculation would not re-establish a cost of debt for purposes of the earnings calculation. AG IB, p. 60. Houtsma acknowledged that there can be significant swings in market conditions affecting the Company's cost of equity. Tr. at 1930. Houtsma concurred that there is a significant amount of judgment that would go into the Company's calculation of earnings and what if any non-recurring or recurring accounting items should go into ComEd's calculation of annual earnings. Tr. at 1937. She likewise admitted that

no criteria or specific dollar thresholds exist that ComEd would use to identify and adjust each of the unusual or non-recurring transactions that would be recorded in future years. Tr. at 1938.

The AG cites to the “myriad of potential discrepancies and controversies that will be generated by ComEd’ proposed earnings test” to argue that Rider SMP should be rejected. AG IB, p. 60. They further cite to the fact that the purported earnings test provides no guarantee that ratepayers will not be paying more than they otherwise should be absent Rider SMP. *Id.*

j. The Commission Should Reject Rider SMP and Open a Docket Exploring All of the Ramifications of Investment in Smart Grid Technologies.

The AG urges the Commission to reject Rider SMP and open a separate docket to explore all of the unresolved issues involved in smart grid investment. AG IB, p. 61. AG/CUB witness Brosch maintains that before the ICC can determine whether costs associated with Smart Grid investments should be recovered in rates, the Commission must first consider the definition of safe, reliable, efficient distribution service and specify what must be done by the regulated business to meet established service reliability and energy efficiency objectives. *Id.*

The AG states that until more specific information is supplied and analyzed by stakeholders on these issues, the Commission simply has no way of determining whether the kinds of investments being described in this case will be prudent and used and useful. *Id.* The AG claims that the record evidence overwhelmingly shows that Rider SMP is neither needed for the Company to invest in new technologies nor legal. *Id.* To support this argument, the AG states that granting approval of an automatic rate adjustment mechanism is particularly inappropriate given the Company’s admission that the Rider SMP investments are “not necessary for the provision of safe, reliable, efficient distribution service.” ComEd Ex. 18.0 (Tierney Rebuttal) at 16.

2. Rider SMP Is Illegal.

a. Rider SMP Violates Section 9-211 of the Public Utilities Act.

Additionally, the AG urges the Commission to reject Rider SMP because it violates Section 9-211 of the Public Utilities Act, which provides that “(T)he Commission, in any determination of rates or charges, shall include in a utility’s rate base only the value of such investment which is both prudently incurred and used and useful in providing service to public utility customers.” 220 ILCS 5/9-211. The PUA requires that the Commission make several critical findings regarding a utility’s plant investments before the costs of new plant are included in the utility’s rate base. AG IB, p. 62. Initially, the ICC must determine that plant investment is prudent as well as used and useful in providing utility service to the utility’s customers. 220 ILCS 5/9-211. Throughout the rate proceedings, the utility has the burden of proving that its investments meet these requirements. AG IB, p. 62.

The AG argues that Rider SMP violates these utility ratemaking precepts by permitting monthly surcharges on customer bills to cover the capital costs of investment. *Id.* These piecemeal rate increases would occur on a monthly basis without any Commission review of the prudence of the investments. *Id.*

ComEd's proposed modifications to mirror some of the provisions in Part 656 alternative Rider QIP permits surcharges for investment in these same four plant accounts does not ameliorate this legal infirmity. *Id.* While Rider SMP would include a prudence review as part of the annual reconciliation of the preceding calendar year SMP surcharges, customer rates would have already increased, reflecting SMP investment prior to any prudence assessment according to the AG. *Id.* The AG concluded that Rider SMP violates the prohibitions contained in Sections 9-211 against including plant in utility rates before a Commission finding that the costs are reasonable and prudently incurred, and that the plant is used and useful in the provision of utility service. *Id.*

b. Rider SMP Violates the Act's Prohibition Against Single-Issue Ratemaking.

The AG states that the ICC must determine whether the proposed rates are just and reasonable and do so within the regulatory parameters which prohibit retroactive and single issue ratemaking. *BPI II*, 146 Ill.2d at 195. Instead of considering costs and earnings in the aggregate, where potential changes in one or more items of expense or revenue may be offset by increases or decreases in other such items, the AG argues that ComEd's Rider SMP proposal considers changes in infrastructure investment in isolation, ignoring the totality of rate base, expense and revenue circumstances, and thereby constituting illegal single-issue ratemaking. AG IB, p. 63. The AG maintains that Rider SMP ignores the traditional ratemaking process, which employs a balanced review of jurisdictional expenses, rate base investment, the cost of capital and revenues at present rates during the test year. *Id.* If enacted, the AG argues that Rider SMP would violate the Act's prohibition against single-issue ratemaking by imposing a surcharge each month on customers' bills based on infrastructure investment in SMP additions, without examining whether the Company's overall cost of service and revenue requirement have increased. *Id.*

The failure of the Rider SMP to incorporate cost savings achieved by Rider SMP project investment also constitutes single-issue ratemaking according to the AG, and given this legal infirmity, ComEd's proposed Rider SMP should be rejected. *Id.*

c. Rider SMP Violates the Public Utilities Act's Prohibition Against Retroactive Ratemaking.

The AG again maintains that Section 9-201 of the Public Utilities Act ensures that rates for utility service are set prospectively. AG IB, p. 64; 220 ILCS 5/ 9-201. Once the Commission establishes rates, the AG states that the Act does not permit refunds if the established rates are too high, or surcharges if the rates are too low. *BPI I*, 136 Ill.2d at 209; *Citizens Utilities Co.*, 124 Ill. 2d at 207. The proposed Rider SMP violates the prohibition in the Act against retroactive ratemaking because Rider SMP would generate monthly surcharges determined by the formula for computing a return of and on SMP investment, as detailed in ComEd Ex. 30.1. AG IB, p. 64.

The Company agreed to incorporate an annual reconciliation and prudence review within Rider SMP. ComEd Ex. 30.0, p. -18. The AG asserts that this retroactive adjustment of rates is not unlike the review ruled illegal in *Finkl*, wherein the Illinois Appellate Court specifically rejected Rider 22's adjustment of rates based on a prudence review, calling it a violation of the rule against retroactive ratemaking. AG IB, pl. 64; *Finkl*, 250 Ill.App.3d 317 at 329.

Given both the absence of both specific statutory authority authorizing the adjustment of customer rates to reflect Rider SMP's monthly adjustment of rates associated with investment in SMP additions, the proposed annual reconciliation of Rider SMP revenues reflecting actual expenditures prudently incurred, as well as the rule prohibiting retroactive ratemaking, the AG argues that the Commission lacks the authority to approve Rider SMP. AG IB, p. 64.

d. Rider SMP's Recovery of Additional Revenues For Capital Expenditures Beyond Those Approved in This Rate Order Violates the Commission's Test Year Rules.

The AG provides that the purpose of the test-year rule is to prevent a utility from overstating its revenue requirement by mismatching low revenue data from one year with high expense data from a different year. AG IB, p. 64; *BPI I*, 136 Ill.2d at 219. The establishment of a test year rate base, reflecting gross additions, retirements and transfers to plant-in-service, concluding with plant balances and total plant-in-service is a critical component of the calculation of each company's revenue requirement. *Id.* at 65. The calculation of ComEd's plant additions or capital expenditures for purposes of setting rates, therefore, is subject to test-year principles. *Id.*

Rider SMP provides for expedited, piecemeal rate increases for incremental capital investment between rate case test years. *Id.* The AG argues that this is in violation of the Commission's test year rules. *Id.* Rider SMP, the AG argues, also violates the Commission's and Illinois law's test-year principles by selecting only one component of the revenue requirement, in this case the financing costs of investment in Rider SMP proposed projects, tracking changes in that revenue requirement component and then assessing rate adjustments to recognize this change. *Id.*

e. Riders SMP Violates the Requirement in the Public Utilities Act That Rates Be Least-Cost.

The PUA makes multiple references to the mandate that utility rates be least-cost. See 220 ILCS 5/1-102, 1-102(a), 8-401. The AG argues that implementation of Rider SMP will permit piecemeal rate increases for plant investment that the Company admits are "not necessary for the provision of safe, reliable, efficient distribution service." AG IB, p. 65; ComEd Ex. 18.0, p. 16. ComEd expects to incur additional revenue requirements above and beyond the rate levels established in this case of \$9.6 million in 2009 to \$120 million in 2012 with Rider SMP. ComEd Ex. 43.1, p. 2. Rates that are increased each month to pay for plant the Company admits is not needed to provide reliable electric delivery service are not least cost and the AG argues that approval of such rates violates the PUA. *Id.*

C. Rider SEA

1. Summary of ComEd's Rider SEA Proposal

ComEd witness Crumrine's Direct Testimony defines the "storm event" that would qualify for Rider SEA treatment and the Company commits to perform an annual audit of the O&M expenses it incurs that would be eligible for Rider SEA consideration. ComEd Ex. 11.0, p. 14. The AG points out that historically, ComEd has incurred storm restoration costs in two forms: (1) costs that are associated with the removal and replacement of damaged units of utility plant, where the costs are capitalized and included in rate base; and (2) costs that are incurred and expensed for re-fusing, emergent switching, pulling slack and reinstalling fallen wire, vegetation/tree trimming, splicing, sleeves, re-lamping and repair or replacement of distribution system parts that are not units of property (not capital). AG IB, p. 66; AG/CUB Ex. 1.0 at 39-40. The capitalized plant replacement costs are routinely added into rate base and are subject to recovery through ongoing accruals of depreciation expense. These capitalized storm restoration costs are not the subject of proposed Rider SEA. *Id.*

For the expensed storm restoration charges, the Company has included in base rates a normalized test year amount for storm restoration expense that tends to vary somewhat from actual costs incurred in particular years. AG IB, p. 66. ComEd's most severe and costly storm restoration effort was on August 22, 2007, when expenses of \$31.9 million and capital costs of \$17.4 million were incurred in connection with a single storm event. AG/CUB Ex. 1.0, p. 41. In ICC Docket No. 05-0597, the Commission established rates including recovery of a five-year normalized amount of storm restoration expenses in the amount of \$18.3 million. *Id.* In subsequent years, any difference between actual expenses and this authorized level was absorbed by shareholders. *Id.*

In the instant case, ComEd is proposing a similar type of averaging calculation to include a normalized cost level within the revenue requirement, but employing an inflation adjusted, six-year average storm restoration expense level of \$27.1 million. *Id.* Using this average expense level, the Company is proposing to reduce the abnormally high test year actual 2006 storm expense by about \$11.4 million. AG IB, p.67. If Rider SEA is approved, future actual storm expenses that are higher or lower than the normalized baseline level of \$27.1 million would result in credits or charges to customers through the proposed new rider. *Id.*

The AG urges the Commission to reject Rider SEA. *Id.* First and foremost, the AG argues that Rider SEA creates piecemeal regulation for an isolated element of the revenue requirement (storm restoration expenses) that is more properly captured using traditional test year regulation. *Id.* Additionally, Rider SEA has the following problems, which are addressed in the AG's Initial brief:

- Rider SEA is ambiguously vague and will not withstand judicial scrutiny;
- Rider SEA fails several of the generally accepted tests for rider recovery (storm expenses not large, not beyond control of management, not volatile);
- ComEd has not demonstrated a financial need for Rider SEA;
- Rider SEA will not stabilize ComEd financial performance;

- Rider SEA may result in over-recovery of ComEd labor costs;
- Rider SEA is not subject to effective Commission monitoring.

2. Rider SEA Would Blunt Regulatory Lag Incentives and Creates Piecemeal Regulation For an Isolated Element of the Revenue Requirement (storm restoration expenses) That is More Properly Captured Using Traditional Test Year Regulation.

The AG is concerned that Rider SEA will require ratepayers to pay the actual storm expenses incurred by ComEd each year instead of subjecting the storm costs to regulatory scrutiny in periodic rate case test periods. AG IB, p. 68. As discussed by AG/CUB witness Brosch, Rider SEA, as well as Rider SMP, removes the incentive for management to control and reduce costs, so as to maximize the opportunity to actually earn at or above the authorized return level between rate case test periods. *Id.* The AG incorporates the same arguments it made against Rider SMP, namely, that traditional rate making causes the shareholders to bear the (i) burden of any costs associated that were not accounted for in the previous rate case and the (ii) gains from efficiencies that are created between rate cases. *Id.* The AG maintains that such a rider for storm expenses incurred above a designated level reduces management's incentive to maintain the delivery system, since costs are passed on to ratepayers. *Id.* Rider SEA, the AG maintains, like all riders, shifts the risk associated with this particular expense item on to ratepayers while shareholders gain from the reduced incentive to maintain the system. *Id.*

3. Rider SEA is ambiguously vague and will not withstand judicial scrutiny.

Another reason the AG gives urging the Commission to reject Rider SEA is that it contains a plethora of ambiguous and vague language that renders it defective. AG IB, p. 69. The proposed rider would apply when, "in aggregate, a total of more than 10,000 retail customers" each lose power for more than 3 hours, "and during or after which the Company activates one (1) or more Emergency Operation Centers (EOCs)." *Id.* There are numerous defects that the AG asserts will allow ComEd to easily satisfy the "more than 10,000" customer requirement by (i) aggregating customers affected by different storms within ComEd's service area, (ii) aggregating customers who were affected by storms weeks or months apart, and (iii) aggregating customers who were not affected by something other than a typical storm. *Id.*

The AG gives an example whereby ComEd would be able to apply Rider SEA treatment when more than 10,000 people *anywhere* in its service area are affected by separate storms. *Id.* For instance, if 5,001 people in the northeastern portion of ComEd's service territory have an interruption for four hours due to a snow storm and 5,000 in the southwestern portion of ComEd's service territory have an interruption for four hours due to a flood, tornado, or other unrelated weather event, ComEd can seek Rider SEA recovery. *Id.*

Second, the AG argues that the tariff ComEd can seek Rider SEA treatment for storms that occur within weeks or months of each other. *Id.* The tariff contains no language limiting the time period in which storms must have occurred to be eligible for Rider Sea recovery, allowing the Company to aggregate storms. *Id.* The AG argues that, by way of example, if a January snow storm in Chicago interrupts service to 5,001 customers and a thunderstorm in May

interrupts 5,000 customers (in Chicago or anywhere in the service territory), ComEd can recover pursuant to Rider SEA because the Company will have presumably activated an EOC for each storm and a total of more than 10,000 customers would have been affected. *Id.*

The AG describes how ComEd's definition of a storm in the tariff permits the Company to seek Rider SEA treatment even though there were no storms or storm systems. *Id.* The definition of a "storm" describes events that are clearly storms or storm systems, such as tornadoes, cyclones, snow storms, blizzards, etc., but it also allows the Company to recover for "any act of nature with disturbance of the physical environment." ComEd Ex. 12.18, Original Sheet 623. This catch-all provision, according to the Initial Brief of the People of the State of Illinois, would allow ComEd to treat as storms all events that are not traditional storms. AG IB, p. 70. The AG states that rain, drizzle, hot weather or snow flurries could be considered storms and trigger Rider SEA recovery. *Id.*

Additionally, the AG argues that by allowing ComEd to collect a rider for almost any weather related event, there will be no reasonable basis for the Commission, Staff and intervenors to determine if certain interruptions were caused by the weather or by an aging system. *Id.* The AG asserts that ComEd could refuse to make required repairs to certain facilities until there is a "storm" and the Company can collect the costs of those repairs from ratepayers. *Id.* The AG argues that Rider SEA should be rejected because ComEd's definition of what constitutes a storm for purposes of triggering Rider SEA surcharges is clouded by vagueness and ambiguity.

4. Rider SEA fails several of the generally accepted tests for rider recovery.

AG/CUB witness Brosch argues that the severity and frequency of storms is clearly beyond the control of ComEd and the expenses incurred are driven by storm activity which can vary significantly from year to year. AG IB, p. 70. However, Brosch states that the expense amounts involved with storm restoration are not particularly large in relation to the Company's total O&M expense or its overall revenue requirement. AG/CUB Ex. 1.0 at 42. In support of this, he cites to the historical variation of actual expenses that comprise the proposed normalized test year expense that ComEd proposed in its direct testimony (\$27.1 million), which ranges from a low of minus \$19.2 million (actual expense in 2002 was \$7.9 million) to plus \$34.2 million (preliminary actual expense in 2007 is \$61.3 million). *Id.* This volatility of plus \$34.2 million in the year 2007, which contained the largest storm in known history (August, 2007), is only about 4.2 percent of total test year O&M expenses, and such volatility is much lower in all other years. *Id.* The 2007 variation in storm expenses above average levels is less than 2% of the Company's overall revenue requirement. *Id.*

Staff witness Luth agreed, noting that "(t)he extent of the fluctuation in storm-related costs is not sufficient to warrant rider recovery as a means of avoiding frequent and otherwise unnecessary general rate proceedings." Staff Ex. 6.0, p. 14. Fluctuations in storm-related expense are therefore not unexpected, Luth concluded, nor are storm-related cost fluctuations sufficiently volatile to the degree that frequent general rate proceedings will result if a reasonable average annual estimate of those costs remains part of costs recovered under base rates. *Id.*

Thus, the AG argues that the size and insignificant volatility of storm restoration expense does not justify extraordinary rate rider treatment. AG IB, p. 71.

Additionally, AG/CUB witness Brosch states that storm restoration expenditure levels are not entirely beyond the control of management, whose first priority should always be public safety and the restoration of utility service as quickly as possible because of the need for management to prudently plan and manage restoration activities to optimize the utilization of resources, such as the Company's vegetation management plan, which is intended to, among other things, minimize the scope and duration of outages caused by storm events, which can directly impact the scope of storm restoration costs. AG/CUB Ex. 1.0 at 42-43. Mr. Brosch also noted that the implementation of the hazard tree removal program attempts to address the scope and duration of future outages caused by storm events. *Id.* at 43. The AG argues that ComEd simply is in a better position to minimize the scope of storm restoration costs than are ratepayers. AG IB, p. 72.

The AG concludes that storm restoration expenses do not meet the *Finkl* standard that expenses deemed appropriate for rider recovery be sufficiently *unexpected, volatile or fluctuating* and urge the Commission to reject Rider SEA. *Id.*

5. ComEd Has Not Demonstrated A Financial Need for Rider SEA.

The AG cites to ComEd's failure to demonstrate a financial need for Rider SEA as yet another reason to reject the tariff. AG IB, p. 72. The substantial evidence of the record supports the conclusion of AG/CUB witness Brosch, Staff witness Luth and AARP witness Smith that Rider SEA is not needed to reflect a normalized level of storm expenses in customer rates. *Id.* The AG states that the storm expense amounts are not large in relation to the Company's total O&M expenses or revenue requirement. *Id.* The 2007 variation in storm expenses above average levels is less than 2% of the Company's overall revenue requirement. *Id.*

The AG asserts that the Company produced no evidence that recent changes in their operations will preclude it from earning reasonable returns in the future under traditional regulation if Rider SEA is not approved. *Id.* at 73. AG/CUB witness Brosch further testified that nothing prevents ComEd from collecting storm restoration expenses under current practice. *Id.* ComEd's current overall cost of service includes an allowance for storm expenses based upon a normalized average of the historical costs that have been incurred and ComEd has been able to function properly for many years without Rider SEA. *Id.*

Mr. Brosch noted that fluctuations in storm restoration expenses are fully recognized in the multi-year averaging approach being employed in this docket to calculate normalized amounts included for base rate recovery. *Id.* While the Company may over-recover its actual expenditures in certain years and under-recover in other years, its actual expenses over future time periods should be fully recovered under this approach that is traditionally used by ComEd and other utilities for recovery of such costs. AG/CUB Ex. 1.0, p. 47. Additionally, the AG points out that there is no other utility that ComEd can identify that has a rider similar to Rider SEA. AG/CUB Ex. 1.0, p. 47.

The AG concludes that while ComEd complains that a static amount of storm expense built into a revenue requirement will never adequately approximate the actual costs incurred, this is true of many types of expenses that are normalized for ratemaking purposes. AG/CUB Ex. 4.0 at 48. With full recovery of a normalized, ongoing cost level in base rates, the expectation for Rider SEA should be for both positive and negative customer impacts from future year to year that tend to net toward zero over extended periods of time. AG IB, p. 74. As long as the overall revenue requirement is reasonable, it is of little consequence when the individual components of the revenue requirement for wages, benefits, sales volumes, bad debts, contract labor and most other costs deviate from rate case allowed levels. *Id.*

6. Rider SEA May Result In Over-Recovery of ComEd Labor Costs.

The AG establishes that significant and varying amounts of ComEd Labor are included in storm expenses eligible for rate tracker treatment. AG IB, p. 74; ComEd Response to Data Request No. AG (MLB) 2.19. Rider SEA would adjust delivery rates for labor cost changes from year to year that are charged to storm tracking projects, even though the Company is unlikely to hire new employees and then later reduce staffing levels because of storms, according to the AG. AG IB, p. 74. The AG maintains that storm restoration work is instead accomplished by deferring other work and/or requiring overtime services from existing employees and Rider SEA could easily result in unreasonable rate recovery of Company labor costs that were fully included in test year expense for the conduct of O&M activities other than storm restoration. *Id.*

7. Rider SEA is Not Subject to Effective Commission Monitoring.

The AG identifies that Rider SEA does not allow any meaningful examination of the prudence or reasonableness of storm expenses that ComEd collects from ratepayers. AG IB, p. 75. The only monitoring requirements provided for in the Company's proposal are that ComEd (i) conduct an annual audit of the operating and maintenance expenses it incurs to restore service following interruptions due to storms; and (ii) submit an annual verified report to the ICC that summarizes the audit. *Id.* The Commission can only "reconcile the actual amounts collected under this rider [SEA] with actual prudently incurred O&M". ComEd Ex. 30.02, p. 4. The AG points out that ComEd does not have to prove that revenues collected under Rider SEA are reasonable or prudent, but only submit to a reconciliation of amounts actually collected. *Id.*

The AG states that this process makes contesting ComEd's classification of Rider SEA costs next to impossible, especially considering ComEd will have an incentive and unfettered authority to list normal replacement or other costs as storm expenses to get ratepayers to bear the burden of these costs pursuant to Rider SEA. *Id.* Staff witness Luth agrees that "ComEd will have the incentive to treat costs as recoverable through the rider because an increase in the charges under the riders will increase revenues received by ComEd." Staff Ex. 6.0, p. 17.

8. Rider SMP is Illegal.

(a) Rider SEA Violates the Act's Prohibition Against Single-Issue Ratemaking.

The AG makes the same arguments as in the Rider SMP section, namely, that the Commission must determine whether the proposed rates are just and reasonable and do so within the regulatory parameters which prohibit retroactive and single issue ratemaking. AG IB, p. 75; *BPI II*, 146 Ill.2d at 195. Instead of considering costs and earnings in the aggregate, where potential changes in one or more items of expense or revenue may be offset by increases or decreases in other such items, ComEd's Rider SEA proposal tracks changes in storm restoration expense in isolation, which the AG asserts ignores the totality of rate base, expense and revenue circumstances, and thereby constitutes illegal single-issue ratemaking. AG IB, p. 75. the AG asserts that Rider SEA, similar to Rider SMP, ignores the traditional ratemaking process, which employs a balanced review of jurisdictional expenses, rate base investment, the cost of capital and revenues at present rates during the test year. *Id.* at 76. If enacted, the AG argues that Rider SEA would violate the Act's prohibition against single-issue ratemaking by imposing a surcharge on customers' bills when these expenses exceed the established baseline level, without examining whether the Company's overall cost of service and revenue requirement have increased. *Id.*

(b) Rider SEA Violates the Public Utilities Act's Prohibition
Against Retroactive Ratemaking.

Similar to its arguments in Rider SMP, the AG argues that Section 9-201 of the Public Utilities Act ensures that rates for utility service are set prospectively. AG IB, p. 76; 220 ILCS 5/ 9-201. Once the Commission establishes rates, the AG declares that the Act does not permit refunds if the established rates are too high, or surcharges if the rates are too low. AG IB, p. 76; *BPI I*, 136 Ill.2d at 209; *Citizens Utilities Co.*, 124 Ill. 2d at 207.

The AG asserts that Rider SEA violates the prohibition against retroactive ratemaking by generating monthly surcharges based on the difference between (1) a specified baseline amount for O&M expenses related to storm restoration and (2) such actual expenses incurred during the previous calendar year." AG IB, p. 76; ComEd Ex. 11.0 at 13 The AG takes issue with the tariff's annual reconciliation of Rider SEA charges, in which surcharges are reconciled with actual storm restoration expenses, and argues that it constitutes another retroactive adjustment of rates similar to the reconciliation ruled illegal in the *Finkl* decision, wherein the Illinois Appellate Court specifically rejected Rider 22's adjustment of rates based on a prudence review, calling it a violation of the rule against retroactive ratemaking. AG IB, p. 76; *Finkl*, 250 Ill.App.3d 317 at 329.

Rider SEA should be rejected in the AG's view because of (i) the absence of specific statutory authority authorizing the adjustment of customer rates to reflect Rider SEA's monthly adjustment of rates associated with storm expenses, (ii) the flawed annual reconciliation proposal of Rider SEA revenues, reflecting actual expenditures incurred, and (iii) the rule prohibiting retroactive ratemaking.

(c) Rider SEA's Recovery of Additional Revenues For Capital
Expenditures Beyond Those Approved in This Rate Order Violates
the Commission's Test Year Rules.

Similar to its objections to Rider SMP, the AG objects to approval of Rider SEA because it violates test-year principles by selecting only one component of the revenue requirement, in this case storm restoration expenses, tracking changes in that revenue requirement component and then assessing rate adjustments to recognize this change. AG IB, p. 77. The AG notes that the purpose of the test-year rule is to prevent a utility from overstating its revenue requirement by mismatching low revenue data from one year with high expense data from a different year. *Id.*; *BPII*, 136 Ill.2d at 219. The establishment of a test year jurisdictional operating income is a critical component of the calculation of each company's revenue requirement. *Id.*

Rider SEA provides for expedited, piecemeal rate increases for incremental storm restoration expenses between rate case test years, in violation of the Commission's test year rules.

(d) Rider SEA Violates the Requirement in the Public Utilities Act That Rates Be Least-Cost.

The AG notes that the Act makes multiple references to the mandate that utility rates be least-cost. AG IB, p. 77; *See* 220 ILCS 5/1-102, 1-102(a), 8-401. The AG argues that implementation of Rider SEA will permit piecemeal rate increases for storm expense amounts that exceed the baseline level established for purposes of the rider tariff. *Id.* at 78. The AG maintains that increasing rates for discrete expense items on a monthly basis for expense items that do not satisfy the legal criteria for permissible rider treatment without examining what is happening with other revenue requirement elements, such as overall revenues or cost of capital, may create rates that are not least cost. *Id.* Thus, this proposal would trigger piecemeal rate adjustments for isolated elements of utility revenue requirements in the absence of compelling evidence that such piecemeal rate adjustments are warranted. *Id.*

VIII. COST OF SERVICE AND ALLOCATION ISSUES

E. Interclass Allocation Issues

1. Across-the-board increase

The AG points out that several nonresidential intervenors have argued that ComEd's cost of service study is seriously flawed. DOE Ex. 1.0, p.3; Nucor, Ex. 1.0, p. 10-11; REACT, Ex. 2.0, p. 9, 18; IIEC Ex. 1.0 (CORRECTED), p. 16. CTA witness Anosike proposes to limit the Railroad class distribution charge to the system average increase or the residential increase, whichever is lower. CTA Ex. 1.0, p. 6. These intervenors reject the study and propose to raise nonresidential rates across-the-board by the overall jurisdictional percentage increase, 21.2%. DOE Ex. 1.0, p.3; Nucor, Ex. 1.0, p. 6; REACT, Ex. 2.0, p 21; IIEC Ex. 1.0 (CORRECTED), p. 3; CTA Ex. 1.0, p 6. The AG points out that they only reject ComEd's cost of service study as it applies to the nonresidential class, not to the residential class, and they propose raising rates for the residential class by 24.7%, which is the residential increase in ComEd's cost of service study. AG IB, p. 78.

The AG argues that if the Commission were to find that ComEd's cost of service study is flawed as applied to the nonresidential class, then the Commission should find that it is flawed as applied to all customers (i.e. residential). *Id.* at 79. AG witness Rubin argues that if the cost of

service study is rejected because it is flawed, then “all customer classes should receive the same percentage increase” because there is “no basis for assuming that any customer class should receive more or less than the system-average rate increase.” AG Ex. 6.0 p. 7-8 (emphasis in original). The AG asserts that nonresidential intervenors want it both ways: they want the residential class to pay higher than average increases for the residential class based on the cost of service study while arguing that the cost of service study is seriously flawed as it applies to the nonresidential class and should be rejected. AG IB, p. 79.

The AG maintains that to apply a different standard for the residential as opposed to the nonresidential class violates fundamental fairness and would impose discriminatory rates on the residential class without any factual basis. *Id.*

3. Shifting of Burden From Nonresidential to Residential Class

The AG supports ComEd’s residential rate design proposal, as it is the more reasonable proposal and avoids adverse impacts on customers by balancing cost of service and the impact of any rate changes. AG Ex 6.0, 121-122. This is done solely through intra-class rate design within the residential class. AG Ex. 6.0, 133-134. This proposal makes no changes in the four residential customer classes that the Commission ordered ComEd to retain in Docket No. 05-0597: single-family space-heating; single-family non-heating; multi-family space-heating, and multi-family non-heating.

However, the AG takes issue with several proposals of intervenors who want to shift nonresidential costs to the residential class. AG IB, p. 79. IIEC’s Embedded Cost of Service Study (“ECOSS”) proposal shifts 14% of the total revenue requirement from the nonresidential to residential classes compared with ComEd’s ECOSS. *See* IIEC Ex. 3.3 and ComEd Ex. 33.1. This amounts to the transfer of over \$100 million in costs from commercial to residential customers. AG IB, p. 80.

AG witness Rubin urges the Commission to reject any proposal to alter the residential rate design if it contains inter-class, as opposed to intra-class, cost allocation. *Id.* Mr. Rubin agrees that ComEd’s residential rate design is reasonable in that it allocates only residential costs to the residential classes and he states that inter-class rate design is an appropriate use of rate design principles. AG Ex. 6.0, 120-44. ComEd did not propose to move any of the residential class’s costs onto other customer classes; it only modified rates within the residential class to try to mitigate the rate impact on space-heating customers. AG Ex. 6.0, p. 6. Such a rate design proposal correctly provides that a class bears its own responsibility for costs it has caused instead of shifting those costs to another party. AG IB, p. 80.

The Commission is urged to reject any arbitrary and discriminatory proposal to shift costs from nonresidential customers to residential customers. *Id.* ComEd’s rate design properly allocates the residential class’ costs between the members of the residential class and requires the customers responsible for the costs to pay for those costs. *Id.* The AG maintains that the nonresidential intervenors in this case have not offered any evidence as to why the residential class should bear nonresidential costs that they have not caused. *Id.* ComEd’s cost of service study adequately allocates costs to the customers who cause those costs and does not allocate them in an arbitrary or discriminatory manner between classes. *Id.* For this reason, the AG

urges the Commission to reject the proposal of IIEC and other intervenors to allocate nonresidential costs to residential users. *Id.*

IX. RATE DESIGN

C. Rate Design Issues

1. Residential: ComEd's residential rate design proposal properly utilizes fundamental rate design principles for residential users and should be accepted by the Commission.

The AG states that the Commission, if it finds that a rate increase is warranted for the residential class, should accept ComEd's proposal to adjust residential rates based on the results of ComEd's cost of service study, which attempts to avoid significantly different levels of rate increases between certain residential customers. AG IB, p. 81. Additionally, the AG states that the Commission should reject the proposals of several intervenors seeking to move the cost responsibility of nonresidential classes onto the residential class. *Id.*

AG witness Rubin testified that the approach that ComEd has taken with regard to allocating costs within the residential class satisfies fundamental rate design principles and strikes a balance between cost of service and the need to mitigate the impact of rate changes on certain residential customers (space-heating). *Id.* Any adverse impact on residential customers is avoided solely through intra-class rate design allocations and none of the residential class's responsibility was shifted to other customer classes. *Id.*

One example that the AG offers to show residential intraclass mitigation occurs in the monthly customer charge. ComEd's cost of service study shows customer-related costs at \$8.25 and \$6.34 for single- and multi-family customers, respectively. *Id.* at 82. However, ComEd proposed charges of \$7.97 and \$7.02 for single- and multi-family customers, respectively. *Id.* The cost of service study also shows the distribution cost per kWh for heating customers is 2.141 cents per kWh but ComEd is proposing a lower rate of 2.060 cents per kWh to mitigate the impact on customers. *Id.*

The AG maintains that these proposals mitigate the impact of the rate increases on residential heating customers and keep the rates at a reasonable level for all residential customers. *Id.* Residential rate design proposals often run the risk of disproportionately benefiting one group over another, but AG witness Rubin concluded that ComEd's residential rate design proposal is reasonable and balances intra-class costs of service differences with the need to mitigate the impact of rate changes on customers. *Id.*

Respectfully submitted,

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